

**Final Report  
Evaluation of the  
Impact of Technical Assistance  
on Russia's Fiscal Reform  
and the Identification  
of Possible Future Work**

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## Acronyms

AmCham	American Chamber of Commerce in Russia
CARANA	CARANA Corporation
CFED	Center for Financial and Engineering Development
CIS	Commonwealth of Independent States
CREA	Center for Real Estate Analysis
EAT	Economic Analysis Team
EEG	Economic Expert Group
EPT	Enterprise Profit Tax
EPTM	Enterprise Profit Tax Model
ESOP	Employee Share Ownership Plan
EU	European Union
Expertech	Members of the National Institute of Economic Forecasting
FFSR	Fund for the Financial Support of the Regions
GDP	Gross Domestic Product
GRP	Gross Regional Product
GSU	Georgia State University
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit (German Technical Assistance Corporation)
HIID	Harvard Institute for International Development
IGFR	Inter Governmental Fiscal Relations
IET	Institute for Economies in Transition
IG-TCCG	Inter Governmental - Technical Component Co-ordination Group
IIT	Individual Income Tax
IITM	Individual Income Tax Model
ITM	Indirect Tax Model
IMF	International Monetary Fund
ITIC	International Tax and Investment Center
KfW	Kreditanstalt für Wiederaufbau (Credit Institute for Reconstruction)
MinFin	Ministry of Finance
MinTax	Ministry of Taxation
NIEF	National Institute of Economic Forecasting
NIS	Newly Independent States
OECD	Organization for Economic Co-operation and Development
PIT	Personal Income Tax
PITM	Personal Income Tax Model
PTIMS	Property Tax Information Management System
RECEP	Russian European Center for Economic Policy
R&D	Research and Development
RMM	Receipts Monitoring Model
SME	Small and Medium-size Enterprise
STI	State Tax Inspectorate
STO	State Tax Police
STS	State Tax Service
TA	Technical Assistance

TA-TCCG	Tax Administration—Technical Component Coordination Group
TACIS	Technical Assistance for Commonwealth of Independent States
TACIS/EU	Technical Assistance for CIS/ European Union
TAMP	Tax Administration Modernization Project
TA-TCCG	Tax Administration Technical Component Co-ordination Group
TRMM	Tax Receipt Monitoring Model
USAID	United States Agency for International Development
VAT	Value Added Tax
ZATO	Zakritoye Administrativno Teritorialnoye Obrazavaniye (Closed Administrative Units in Nuclear Zone)

## **Executive Summary**

This report provides a selected review of recent Russian fiscal policy reform efforts and of donor efforts to support that reform. The report begins with an assessment of Russia's current fiscal problems, their underlying causes and prospects for change. The report then describes the efforts made under the USAID-sponsored technical assistance (TA) project administered by Georgia State University (GSU). The report attempts to evaluate those activities, to identify the various internal and environmental factors that influenced performance, and to assess the extent to which the project helped to move fiscal reform forward. Although the focus of this study is on the GSU project, it also includes a brief review of the TA provided on Russian fiscal reform by other USAID-financed institutions and by other donors. On the basis of these reviews, the authors attempt to draw lessons about the characteristics of successful TA for Russian fiscal reform and to make recommendations to USAID about future investments in this area.

### **1. Russian Fiscal Policy and Management**

Post-communist economic transition necessarily involves a complete redesign of the public sector--a difficult and complex task. Russia is among those post-communist countries that are confronted with both greatly reduced revenues from a shrunken tax base and urgent demand for transfers to individuals and enterprises affected by the economic decline. Revenue collection still falls far short of the country's fiscal needs, although the latter are bloated by poor resource allocation and persistent subsidization of enterprises at the local level. Saddled by large government debt and arrears, the Russian government at all levels has placed an excessively heavy burden upon taxpayers. In response, many Russians evade taxes by hiding their activities in the underground economy. Barter transactions, arrears and mutual arrears offsets, and various extra-budgetary transactions undermine the transparency and efficiency of fiscal management. Meanwhile, a plethora of special arrangements with favored sectors and enterprises has created a set of powerful interests opposed to reform.

Russia's 1991 Law on Basic Principles of Taxation established the basic taxes, including the personal income tax (PIT), enterprise profit tax (EPT), and value-added tax (VAT). Subsequent legislation and administrative decisions have created a complex, inconsistent, and incoherent tax system. That system is made even more complicated and non-functional by a complicated and irrational organizational structure in which parallel and often over-lapping responsibilities are exercised by the Ministry of Finance (MinFin), Ministry of Taxation (MinTax, formerly State Tax Service [STS]), the State Tax Police (STP), and the institutions administering four separate payroll taxes (for pensions, disability, etc.) that operate outside the main tax system. Efforts to create an integrated, consistent Tax Code were initiated in the mid-1990s but have so far been only partially successful. After considerable delays, Part I of the Tax Code finally passed in 1998. Part II, setting rates and guidelines for each type of tax, is being gradually introduced under separate laws for each type of tax.

Aside from the current system's failure to collect adequate revenues, imposition of excessive burden on enterprises, and encouragement to evade taxes, the EPT and VAT are also anti-growth in not allowing deductions for certain legitimate business expenses. Furthermore, there is little or no coordination (and no centralized database) among the seven separate tax collecting agencies (MinTax, STP, Customs Committee, and the four payroll tax administrations); MinTax only partly controls local tax collection offices (which are also heavily influenced by local and regional governments); and there is widespread political interference in the enforcement or non-enforcement of tax liabilities.

Russia's intergovernmental fiscal relations are poorly defined and create perverse incentives. Although the tax system is highly centralized, the 1990s have seen a broad shift of expenditure assignments from the federal to the regional and local levels. While federal-regional fiscal relations are by now largely governed by legislation and rules, tax-sharing between the center and the regions still leads to efforts by the regions to obtain revenues (in cash or kind) from enterprises and to reduce transfers to the center. Likewise, intraregional fiscal relations, which are still run in large measure on a discretionary basis, are based on tax sharing principles that create incentives for local governments to maximize collection of revenues they can retain and to ignore others.

There are profound inequalities in income, revenue and public expenditures among regions, and even among municipalities in the same region, with the result that compensatory transfer mechanisms are required to achieve a greater measure of equality in public goods and services provided. This, however, leads to a tendency to overspend by both regions and localities, each expecting compensatory transfers from the next higher level of government to make up the gap between expenditures and revenues.

The current division of functions and resulting rivalries between the Federation government agencies responsible for tax collection and policy constitute a major obstacle to reform, as do the tensions in this area between the federal and regional governments. These tensions are reflected also in the hitherto difficult relations between the Federation government and both branches of the national legislature.

The lack of consensus-building efforts by the Federal government in the area of tax policy reform has been another negative factor, as have been the special interests created by the present system. Nevertheless, the Russian business community—outside the natural resource and financial sectors which have received special favors from the government—has become increasingly assertive in demanding tax reform. Moreover, the August 1998 crisis has convinced the government that “something must be done,” and the recent Duma elections, as well as the expected election of Vladimir Putin as President, may create an opportunity for faster progress on tax reform.

## **2. The GSU Program: Output, Activities and Impact**

GSU's \$11.3 million contract with USAID covers the 2.25-year period extending from the beginning of 1998 to March 2000. Under that contract GSU is to provide technical assistance in five areas: tax policy and legislation, tax administration, economic analysis,

intergovernmental fiscal relations, and real estate taxes. The contract establishes tasks that include assisting the Federation government with the preparation of tax policy legislation; helping the STS (later MinTax) improve taxpayer registration, monitoring, auditing, and large taxpayer administration; improving existing models for analysis of the revenue impact of tax legislation; improving policies for assigning fiscal responsibilities to different levels of government; and continuing the previous real estate tax pilot project in Novgorod and Tver.

The project's ambitious benchmarks included enactment of a new tax code, reorganization of the STS, and enactment of new legislation for intergovernmental fiscal relations. These goals were in good part not reached, owing largely to adverse environmental factors, among which were frequent changes in political leadership, economic decline and financial crisis, and coordination problems within the Federation government. GSU's work and impact were also affected by troubled relationships with other TA contractors and by a reduction in planned project funding.

***Tax policy.*** GSU's main effort in tax policy was with MinFin, but it also worked with MinTax, and with the Budget Committee of the Duma. Because the Duma passed only Part I of the Tax Code in mid-1998, remaining legislative work focused on specific taxes (the personal income tax, PIT, and the enterprise profit tax, EPT), emergency revenue measures after the August 1998 financial crisis, the "19 Law" Package to Support the 1999 Budget, and the tax provisions supporting the 2000 budget. GSU prepared useful comments on legislation, tax revenue estimates, analyses of specific issues, and international comparisons. GSU's work the Duma Budget Committee helped to bring that organization into the reform process. Similar work with the Russian private sector might have helped to create additional impetus for reform.

***Economic analysis.*** The main thrust of GSU's economic analysis work, which supported its tax policy program, was to update and further develop several fiscal models created by Barents—on PIT, EPT, indirect taxes, and tax receipt monitoring—as well as a large macroeconomic input-output model developed with a local institute. The revenue forecasting models have been transferred to MinFin and provide a useful start to building revenue forecasting capability. Because of poor data, the large model has limited current usefulness, although it does provide a foundation for economic forecasting capabilities when better data are available and the economic structure is more stable. The GSU team also provided analytical studies on various topics, including fiscal analysis of the oil and gas industry, tax arrears and offsets, the taxation of capital, and tax burden on labor income. When permitted by MinFin, these research outputs were widely disseminated.

***Tax administration.*** GSU carried out a series of studies and in early 1999 produced a major report containing an action plan for both computerization and reorganization of MinTax. However, difficulties of coordination with the Barents and Treasury teams eventually led to a USAID decision in October 1998 to phased out GSU work in tax administration.

***Intergovernmental fiscal relations (IGFR).*** GSU work in this area was on two levels: on Federation-oblast relations, and intraregional relations. With regard to the former, the GSU team contributed, *inter alia*:

- an improved conceptual basis for the transfers of the Fund for the Financial Support of the Regions (FFSR), including an improved equalization formula;
- a comprehensive paper on fiscal decentralization, which is widely regarded as the authoritative source on this subject;
- a document on methodology for a regional intergovernmental fiscal reform strategy, which is expected to become the basis of government legislation in this area;
- papers and documentation on regional finances, developing a revenue capacity methodology and indexation of budget expenditures for the regions; and
- a regional-municipal database with data from most regions and information of the composition of sub-national governments for 87 of 89 regions.

With respect to regional-municipal relationships, the project assisted the Leningrad, Tomsk, Novgorod, Vladimir, Rostov and Tyumen regions. In both places, GSU experts helped establish fiscal capacity and expenditure norms for municipalities, in order to create more rationality and transparency in fiscal relations between oblasts and municipalities. However, this work may be of limited usefulness in the absence of legislative action that would reduce tax burdens and rationalize the national tax structure.

***Real estate taxes.*** GSU was to complete the pilot projects in Novgorod and Tver, developing a legal framework and other legal and institutional support for real estate tax reform. The project developed a real estate tax information management system, analyzed changes in expected tax burdens, organized the process of sending out assessment notices, and provided legal and regulatory assistance with tax administration procedures. The last stage of the project, assistance with public relations and education programs for taxpayers, was never reached, because the program was ended in July 1999, due in part to failure of the Duma to pass necessary enabling legislation. City of Novgorod officials plan to move ahead with a real estate tax and are desirous of additional assistance. Other municipalities have also expressed interest.

***Overview of project performance.*** GSU provided a considerable quantity of technical assistance and training, most of which was of high quality. Project managers focussed on activities that responded to needs expressed by counterparts. The evidence shows that counterparts valued the GSU work highly.

Although GSU's work succeeded in nudging Russian officials along the path of fiscal reform—or stopped them from taking actions that would have made the situation worse—the short-term impact of the project has been limited, and many of the project's benchmarks are yet to be achieved. The most important constraint on impact has been a lack of Russian political will and widespread consensus about reform. A number of other factors, some of which could be influenced by the contractor and others not, also contributed to the lack of more significant progress. The final assessment of the project's impact, however, will not be known for some years, since many of GSU's reports and

recommendations are still being discussed and the people that it helped to train are actively involved in fiscal policy management.

More specific findings about the project include:

- GSU generally provided capable, experienced staff, though some without Russian experience, and was successful in recruiting and training Russian experts.
- The selection of activities and quality of work were of international standards.
- The effectiveness of the project was constrained by Russia's failure to enact fundamental reforms (e.g., improvements in intraregional fiscal relations) or reforms better geared to Russian conditions (real estate tax project).
- GSU project management, which initially had limited experience in managing large overseas projects, needed to deal with many difficult issues and carried out most of its tasks successfully.
- The project's goals and benchmarks were highly ambitious (perhaps unrealistic) for the two-year time frame of the project.
- The one-third reduction in the project budget, occurring mid-way through the short contract period, reduced the scope of GSU's activities.
- Poor coordination of the TA providers working on tax reform, resulting in part from inadequate clarification of roles before GSU's arrival in Moscow, lessened the potential synergistic effect of the various activities. USAID resolved this problem during the course of 1998.
- Russian readiness for reform was limited. Consensus-building efforts of the project with the State Duma helped; similar efforts with the staff of the Federation Council and representatives of the Russian private sector would also have helped.
- GSU was responsive to the stated needs of Russian counterparts, and in general the GSU team members established good rapport with their counterparts.
- GSU succeeded in transferring knowledge and skills to staff members of MinFin, MinTax, and the Duma, six regional administrations, and two municipal administrations. It also mobilized and provided further training to a team of Russian specialists employed by the project. Both of these training functions help with the sustainability of fiscal reform efforts in Russia.

### **3. Technical Assistance from Other Programs**

Besides U.S. TA providers, the main donors in the fiscal area were the World Bank, IMF, and the European Union's program of Technical Assistance to CIS Countries (TACIS). Most of these programs have been shorter and less comprehensive than USAID-sponsored activities. The evaluation team saw little evidence that these programs were particularly more or less successful than USAID programs, although it is difficult to assess the impact of individual activities when there are many trying to move the fiscal system essentially in the same direction.

***Tax policy.*** Advice on specific tax policy issues was contributed by programs financed by the U.S., German, Japanese, Swedish and U.K. governments. USAID, in addition to supporting the work of GSU, Barents and the U.S. Treasury, also financed a grant to the Institute for Economies in Transition (IET). IET hired several U.S. advisors with

experience on earlier USAID tax reform projects to provide advice on tax reform issues. TACIS helped prepare a simplified version of the Tax Code for the use of Duma members and others. TACIS is currently preparing a major program in tax policy, which would make available European expertise, experience and documentation for a wide range of taxes. Coordination among these programs has been poor.

***Economic analysis.*** A TACIS-supported research center, the Russian-European Centre for Economic Policy (RECEP), uses a team of expatriate and Russian economists to produce reports on economic trends, papers on economic policy, and workshops. Another TACIS project studies ways in which different levels of the Russian government intervene in the economy, focusing on regulatory activities.

***Tax administration.*** The IMF and the U.S. Treasury have worked with MinTax and its predecessor, STS, to prepare for the World Bank's TAMP program. Several donors—including TACIS, the OECD, and the Danish government—operating through the Moscow International Tax Training Centre—have provided training on tax administration. There has also been some bilateral aid in this area. Except for close coordination among the IMF, Bank, and Treasury, there has been little coordination with or among the European donor efforts.

***Intergovernmental fiscal relations.*** The German Technical Assistance Corporation (GTZ), working with World Bank support, has assisted selected regions with budget management. The TACIS research project mentioned above focuses on regional policies. The World Bank, which has been in close touch with the GSU regional projects, is planning a large intergovernmental project in six regions, based on GSU's previous work.

***Other Fiscal TA.*** The IMF and World Bank have for several years been helping MinFin build a nationwide Treasury System for the control and disbursement of expenditures. A major new World Bank project in this field is in the offing.

#### **4. Findings: What Has Worked, What Has Not worked, and Why**

During a period where there has been limited ability of the Russian Government to adopt and implement fiscal reform, the impact of donor TA has necessarily been modest, albeit useful. In reviewing the work of GSU, other USAID-financed providers and other donor programs, the evaluation team has attempted to identify principles that might help future TA providers to increase impact. The team's conclusions in this regard are as follows:

***Meeting Russian needs.*** Russian counterparts expect advisors to be sensitive to the Russian situation and political constraints and capable of coming up with relevant, concrete proposals, in forms readily usable by Russians. This implies that TA normally must be demand-driven, i.e., that it help counterparts move in a direction in which they want to move. At the same time, TA providers should not respond to every request; they need to have a vision and strategy against which they can assess requests for assistance, rejecting those which would be counterproductive.

***Characteristics of TA providers.*** Not surprisingly, expatriate experts seem to be most successful when they are Russian speakers, resident in and knowledgeable about Russia, and of high professional competence and broad international experience. When expatriate advisors lack one or more of these attributes, TA has worked best when the expatriates are linked closely to well-trained, English-speaking Russian professionals.

***Continuity.*** Russian counterparts have found continuity in TA provision helpful, both to avoid their having to re-educate a new set of advisors about the Russia environment and to build new personal relationships with advisors.

***Building Russian capacity.*** The development of institutional capacity, obviously a prerequisite of sustainable reform, is impeded by government pay scales which make it difficult to attract and retain quality staff. When this occurs, TA providers have difficulty finding suitable technical staff to whom to transfer skills. GSU and other donor that hire and train Russian staff are playing a useful role; many of these individuals will eventually serve in key Russian institutions. In future activities, targeting capacity-building within the government and think-tank organizations should be given careful consideration.

***Building consensus.*** To generate support for fiscal reform, more needs to be done to raise the level of knowledge about fiscal reform issues within key Russian institutions. In this regard, the GSU program extending TA to the Budget Committee of the State Duma was very helpful. Other Russian institutions now need be brought into the national dialogue on tax reform. Dissemination of information is also important for consensus-building and has probably been given too little attention.

***Coordination of donor efforts.*** The record with respect to donor coordination on fiscal reform issues has been mixed, sometimes reducing the impact of technically excellent work. Better coordination of donor efforts would help to build intra-governmental coordination and avoid wasteful duplication of efforts.

## **5. Recommendations.**

The team's recommendations are presented in two parts: first, general considerations about technical assistance programs designed to promote fiscal reform, and second, recommendations with regard to specific fiscal topics that need to be addressed.

### **Building Effective Technical Assistance Programs**

***Continue technical assistance on fiscal reform.*** Progress on fiscal reform in recent years has been slow and inadequate. Russia's financial collapse of September 1998 was largely a result of the country's failure to address fundamental fiscal issues. Russia has thus paid an enormous price for its lack of progress in the fiscal area. Nevertheless, some progress on reforms has been realized, and the assistance of GSU and other technical assistance providers has played an important role in that process.

The recent election of a more centrist Duma and the expected election of Acting President Putin should make it likely that confrontation between the Russian administration and the legislature will subside, making progress on fiscal reform possible. An improved political environment is a necessary condition for reform, but it is not sufficient. Russian officials at all levels still lack adequate experience with modern, market-oriented fiscal systems, and key institutions lack well-trained and competent technical staff. Russia is still in acute need for TA in the fiscal area; donors must continue to meet this need for assistance, keep focussed on key reforms and be patient.

***Russian demand for targeted and practical advice.*** Russian counterparts' future demand for TA will be in the form of carefully circumscribed, targeted advice for specific purposes. Those delivering these techniques, however, should not forget the overall weaknesses of the Russian fiscal system nor fail to use the opportunity to communicate their broader vision and insights to their counterparts.

***Capacity building.*** USAID and other donors should explore options for developing capacities for fiscal analysis and implementation both inside the government (which will require improved incentives to retain qualified staff) and outside the government (e.g., think-tanks).

***Consensus-building.*** Recent successful work with the State Duma should be followed up by similar work with the Federation Council, the regional governments it represents, and the private sector. (The points below on dissemination and donor coordination are also relevant in this regard.)

***Dissemination of information.*** Disseminating appropriately written reports and articles can be a major means of educating stake-holders and building consensus. Future projects should provide sufficient resources for vigorously disseminating reports and best practices throughout the country and for educating the general public on tax policy issues.

***TA for the regions.*** The capacity of regional governments to implement fiscal reform is severely constrained by lack of qualified personnel. There is a need for proactive interregional dissemination of policies and structures successfully-tested in pilot regions. TA providers need to finance and support such efforts.

***Characteristics of TA providers.*** As mentioned, experts should ideally have international credentials, know Russian, be resident full-time and be fully conversant with Russian circumstances. Where language or residency qualifications cannot be met, expatriate experts should work closely with full-time Russian technical staff.

***Continuity of TA provision.*** As Russian counterparts prefer sticking with the same group of TA providers for an extended period, donors should, to the extent that their procurement regulations permit, minimize changes in personnel that are performing effectively.

**Donor coordination.** More effective coordination among donors is essential. Coordination could be facilitated by an annual (or semi-annual) donor workshop. Participation might include high-level government and private sector representation.

With regard to USAID-financed assistance, recent experience suggests that it would be useful to avoid having more than one agency provide TA in a specific fiscal area. If there is overlap, USAID needs to clarify each TA provider's specific responsibilities before they commence field activities. Once implementation has begun, providers should hold regular coordinating meetings and frequently exchange information. USAID may wish to experiment with making TA providers part of a strategic objective team and holding them jointly responsible for achievement of strategic objectives.

**The need for fundamental reform.** In providing demand-driven assistance to what is likely to continue to be a gradual process of reform, TA providers must nevertheless have clear goals and criteria for deciding what assistance is worth providing. The evaluation team suggests that the following fundamental reform goals be incorporated in USAID assistance:

- *Eventually eliminating shared taxes.*
- *Restructuring the Federal tax collection system, reducing the number of tax collecting and enforcement agencies from the present number of seven.*
- *Reducing the burden of taxation on enterprises.*
- *Increasing the scope and transparency of official budgets at all levels of government.*

### **Priority Technical Areas**

**Tax policy.** TA programs should continue previous work, providing MinFin and MinTax with ad hoc analyses and forecasts for specific policy proposals. But this should be done within a mutually agreed list of priorities, including consideration of the social fund contributions and their burden on enterprises. TA providers should continue working with both the Federation government and the national legislature, incorporating also the Federation Council staff and regional governments.

**Economic analysis.** The evaluation team questions the usefulness of a separate economic analysis component. In any case, programs should include assessment of the economic efficiency of the tax system, not just revenue projections.

**Tax administration.** Although the World Bank plans to finance a large program to modernize tax administration, other expertise will be needed in the complementary areas of organizational restructuring and staff development.

**Intergovernmental fiscal relations.** Russia continues to require assistance on improving the procedures for allocating resources to public services and generally on establishing more transparent and accountable procedures. However, the overall tax system needs restructuring before there can be useful work in improving tax collection and tax sharing procedures between local and regional governments.

***Real estate tax.*** The Russians want to continue development on real estate taxes, including work on national legislation to make such taxes available nationwide. This effort merits donor support. This work should include an attempt to develop a simplified real estate tax system suitable for Russia and amendment of the Tax Code to make the property tax a strictly municipal tax.

***Other areas.*** More work needs to be done on reforming budget formulation and implementation in Russia. A forthcoming large World Bank project in this area could well be supplemented by work from other donors, including USAID.

## I. Introduction

Since the inception of its program in Russia, USAID has viewed fiscal reform as a key component of its effort to assist in that country's transition to a market economy. An intergovernmental finance project carried out by the Barents Group began in 1994, and in 1995 the Center for Financial Engineering in Development (CFED) began USAID-sponsored work on development of a municipal real estate tax. Starting in 1995, the Barents program and work of the U.S. Treasury, whose own advisory program in Russia began in 1992, functioned under the general coordination of the USAID-financed program of the Harvard Institute for International Development (HIID). The coordinated program focused on federal tax legislation, tax administration and training, and economic analysis, as well as a pilot municipal tax collection and forecasting module carried out by Georgia State University (GSU).<sup>1</sup> USAID/Russia terminated its contract with HIID in the latter part of 1997.

USAID issued a Request for Proposals for a new tax reform project, "Tax Reform in the Russian Federation," and, in December 1997 awarded the new contract to GSU. GSU had previously been involved in two modules of the earlier project.<sup>2</sup> The GSU consortium's implementation of the new project began on January 15, 1998; the last module of this project is due to be concluded on March 31, 2000. The planned project budget was \$15.3 million for two years, with a possible extension for a third year and budget increase to about \$20 million. The actual project budget is \$10.6 million for a 2.25-year period.

As will be explained in greater detail in Section III of this Report, the GSU project has had five major components:

- Tax policy,
- Economic analysis,
- Tax administration,
- Intergovernmental fiscal relations (IGFR), and
- Real estate taxes.<sup>3</sup>

Now, after some five years of USAID's involvement in this field, and eight years of efforts by U.S. agencies overall, USAID is reassessing the progress that has been made, the reasons underlying successes and failures, and possible directions for the future. This evaluation forms part of that assessment activity.

The scope of work for this evaluation focuses on the GSU project, USAID's principal activity in the fiscal area at this time. However, the scope of work also asks the CARANA evaluation team to look at other donor technical assistance (TA) in this field,

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<sup>1</sup> USAID/GSU Contract, pp. 7-9.

<sup>2</sup> GSU's previous work included providing advice to improve tax monitoring and audit procedures in a few districts of the Moscow City tax inspectorate and framing proposals to improve the formula for the transfer of federal funds to the regions.

<sup>3</sup> Although some of the documentation of the project refers to this module as the "property tax project," the term "real estate taxes" will be used to distinguish this (for Russia) new, market-value-based tax from the other forms of property taxes that were established earlier.

to reflect generally upon the reasons for progress or lack thereof in fiscal reform, and to make recommendations on how donor assistance could best contribute to future reform efforts. Thus, in this report the evaluators attempt to provide both a review of the GSU project and a broader assessment of the Russian fiscal reform effort. Because of the complexity of the fiscal reform task in Russia and the limited time and resources available for this review, this report is necessarily a selective and suggestive survey of the problem, rather than a definitive study of Russian fiscal reform.

The CARANA evaluation team consisted of Anthony Lanyi (leader), Jitendra Modi, and Leonid Polishchuk. Mr. Lanyi is Director, Macroeconomics and Economic Policy, at the Center for Institutional Reform and the Informal Sector (IRIS), University of Maryland, College Park, and a former IMF official. Mr. Modi, a fiscal consultant, is also a former IMF economist. Leonid Polishchuk, a Russian economist, is a long-term consultant with the IRIS Center and also teaches university courses in Moscow. The team worked under the supervision of Gerald Wein, a former USAID economist and program manager who is currently a consultant to CARANA for evaluation methodology and management.

The evaluation team's methodology included a review of project management and technical documents, a review of other relevant background materials on Russia's fiscal reform, and interviews. The team's 60+ interviews included personnel from USAID, GSU and other contractors, Russian counterparts at all levels of government, experts in Russian research organizations and in the private sector, officials of various bilateral and international donor agencies, and outside experts on the Russian fiscal situation. The team worked for approximately seven weeks, including three weeks in Russia.

This Report is organized as follows. After this introductory section, Section II discusses Russia's economic and fiscal environment and the principal issues for fiscal reform. Section III describes the GSU project, its activities and outputs; it is organized around the five principal project components and ends with the team's overall assessment of performance. Section IV provides a summary of the fiscal reform activities of other donors. Section V summarizes the team's findings on what worked, what did not, and why. Section VI provides the team's recommendations for future TA for Russian fiscal reform. The report's annexes provide additional information on the CARANA team, persons interviewed for this report, a bibliography, and the evaluation's scope of work.

The CARANA team wishes to express its appreciation to USAID/Russia staff—especially Elaine Grigsby, Denis Korepanov, Yulia Shevchenko, and Tracy Thoman—for their assistance in providing documentation, contacts, and other information during the course of preparing this report. The team also wishes to thank the many Russian counterparts and observers who gave generously of their time and ideas. It is also grateful for the additional information provided by GSU staff in Atlanta and Moscow, to those interviewed from other donor organizations, and to the CARANA staff in both Arlington and Moscow for their valuable logistical support.

## **VII. II. Background**

### **1. Public Finance in the Russian Transition**

Fiscal reform is a central task of post-communist economic transition. Since such transition necessarily involves economic liberalization and the drastic reduction of the role of government in the economy, it also requires a complete redesign and overhaul of the public sector, with a redefined set of government functions and new sources of revenue. Such reform poses a host of intricately linked economic, political, administrative and legal problems.

In some Eastern and Central European countries outside the Commonwealth of Independent States (CIS), progress in fiscal reform has paralleled the overall advance of post-communist transition. In these instances, rapid and wide-ranging restructuring of the economy, and ensuing economic growth, have reduced the dependency of firms and households on public support, and at the same time generated sufficient revenues for governments to fund provision of public goods and social safety nets. Healthy economies also contribute to political consolidation, which in turn allows reformist governments to pass the necessary laws underlying new public finance systems and to ensure broad compliance of taxpayers. By contrast, countries trapped in prolonged transitional recessions are confronted with the double fiscal jeopardy of dwindling revenues from severely diminished tax bases and urgent demand for massive financial transfers to the large numbers of unemployed or underemployed workers and their families. Economic failures in such countries breed public cynicism, political turmoil and social division, thereby making it difficult to reach the broad consensus necessary for legislating and implementing comprehensive fiscal reform.

Since the early 1990s Russia has been following the second of the above scenarios, with chronic fiscal and economic crises feeding upon each other. Being unable to collect sufficient revenues, the government initially resorted to inflationary financing of the fiscal deficit, building up massive debt both before and after the stabilization achieved in 1996. Both inflation and the government debt build-up caused heavy damage to the economy, and in particular to private investment, which was first stifled by high inflation, and subsequently crowded out by government borrowing. Another form of deficit financing was budgetary arrears—essentially non-voluntary lending to the government—including delayed salaries to public sector employees and state pensions. The build-up of arrears, in turn, reduced household disposable income, thereby further diminishing the possible role of private domestic demand in generating economic recovery. Finally, in order to reduce its own fiscal deficit, the Federation government has transferred substantial expenditure responsibilities to subnational governments in the form of unfunded mandates.

The accumulation of debt and arrears further burdens Russian public finance, nullifying efforts to improve current tax collection and to cut ongoing program expenditures. The inability of the government to service its mounting debt led to the financial meltdown of August 1998, accompanied by a collapse of the banking system and eventual four-fold

devaluation of the ruble. The following economic recovery, resulting from the devaluation together with the rise of oil prices on the global markets, allowed some improvement in revenue collection by the fall of 1999. While these favorable changes have temporarily reduced the central government budget deficit, the cost of servicing the government debt remains high and the sustainability of the fiscal improvement is not yet certain.

The government, still desperate to maintain tax collections, has placed an excessively heavy burden upon those taxpayers who file, prompting massive tax evasion and growth of the underground economy. A frequently practiced means of tax evasion is the use of barter transactions, which are relatively non-transparent to the tax authorities. Another source of non-payment originates with arrears, which are often initiated in transactions between businesses and the government, and spread throughout the economy. Both the government and taxpayers routinely fail to meet their payment obligations, and tax offsets have become a common practice. Offsets in lieu of cash remittance, along with other surrogate forms of tax payments, further erode the revenue collection capacity of the government. These practices also undermine the transparency of government procurement procedures and reduce the efficiency of budgetary expenditures. Thus, persistent fiscal problems are tightly connected to the prevalence of both barter transactions and arrears in the Russian economy.

Russian tax reform is further complicated by decisions taken earlier in the Russian transition process. Creation of a modern and efficient public finance system was not a priority of reformers at early stages of post-communist economic transformations, when the emphasis was instead on economic liberalization, privatization and financial stabilization. By the time fiscal reform was taken from the backburner and attempted in earnest, it was opposed, especially at the regional level, by a nexus of rent-seeking economic and political interests, which had emerged in the early transition years. These interests would be adversely affected by a transparent and effectively enforceable tax system: favored enterprises would be deprived of special privileges and government officials, of payoffs. These special interests include the “oligarchs” and lobbies representing such sectors of the economy as extractive industries, banking and agriculture.

In general, Russia still has not developed a culture of compliance with tax law, which is an important component of the “rule of law.” Further, it lacks the administrative tradition and capacity to collect revenue from a decentralized, privately owned economy, and old habits of negotiated discretionary arrangements and “soft budget constraints” are dying hard.

Overall, the Russian government still fails to ensure revenue collection sufficient to meet the country’s fiscal needs, and a central government budget deficit has been a chronic feature of Russian public finance throughout the country’s post-communist history. In 1998 tax collection in Russia was estimated at 68% of the assessed tax liabilities. Tax liabilities, of course, are based only on the official part of the economy. Since informal sector output is estimated at 25 to 50 percent of GDP, the actual level of tax collection is

not more than half, and possibly as low as one-third, of its potential level. This incidence of tax evasion is indicative both of the failure of tax authorities to ensure compliance, and of a tax burden so oppressive that it prompts economic agents to seek refuge in the shadow economy.

## **2. Tax Reform in Russia**

The Russian post-communist tax system dates back to late 1991 when the Law on Basic Principles of Taxation was passed. The purpose of this law was to replace the old tax system inherited from central planning with a modern one, suitable for a market economy. The law established, *inter alia*, exclusive lists of federal, regional and local taxes. Federal taxes included a personal income tax (PIT), an enterprise profit tax (EPT), a value-added tax (VAT), and excise taxes. Specific laws on individual taxes followed shortly afterwards. The legal foundations for tax administration were laid by laws on the State Tax Service (STS)—later changed to the Ministry of Taxation (MinTax)—and the State Tax Police (STP), which is subordinate to the Ministry of Interior.

Four payroll taxes, known as contributions to social funds and designated to finance particular social programs and services—most notably, the Russian public pension system—have been established. These operate outside of the main tax system, each with its own separate system of collecting contributions and administering payments.

The above-mentioned tax legislation has been subject to numerous amendments, often *ad hoc* and driven by short-term political considerations. A case in point was the unrestricted freedom for regions to introduce their own taxes, granted in 1993 and repealed three years later, after regions had responded with over 200 different taxes, often low-yield and with high administration costs. In addition to amendments of tax laws, tax authorities and the Ministry of Finance retained broad powers to issue regulations affecting tax administration. As a result, by early 1997 the Russian fiscal system was regulated by some 30 laws and over 900 instructions. The result of all these changes is an inefficient, inconsistent and incoherent tax system, incomprehensible to taxpayers and probably to most tax inspectors as well.

To create a streamlined and consistent legal foundation for the Russian tax system, the government in the mid-1990s concentrated its efforts on drafting a comprehensive Tax Code, and drafting this Code was for many years the focal point of international TA to Russian fiscal reform. The main partners in drafting the first version of the code were a group of Russian experts and reformist politicians headed by Deputy Minister of Finance Sergei Shatalov, and a team of international advisors, working with USAID financial support and led by the Harvard Institute for International Development (HIID). The goal of the drafters was to eliminate numerous inefficiencies in the tax system that had emerged in Russia in the first years of transition, by creating a new, modern, law-based system, reflecting state-of-the-art public finance knowledge and the experience of tax systems in developed market economies. Apart from other benefits, this Tax Code was expected to signal Russia's commitment to sound public finance and the rule of law.

The drafters rejected the second-best approach, which would have allowed a less-than-perfect tax system reflecting the idiosyncratic features of the Russian transition economy. The draft Tax Code, known as “the Shatalov draft,” was met with strong resistance in the State Duma. Although the government managed to ensure its passage in the first reading in 1997, under pressure from the IMF, thousands of amendments ensued afterwards, prompting the government to withdraw the draft from further hearings.

A new draft Tax Code was resubmitted the following year, after a profound revision reflecting earlier criticisms. It was passed in the first reading, winning over almost a dozen alternative drafts. However, only Part I of the Tax Code, establishing general principles of the Russian tax system, has been enacted into law. Part II, which sets rates and guidelines for each type of tax, is still pending, and in all likelihood it will not be passed as a whole, but instead will be gradually assembled from separate laws regulating individual taxes. Duma opposition to Part II can be partly explained by the sheer obstructionism of anti-government parties, but partly also by the length and detail of the legislation, and also because particular existing provisions were seen by some special interests as being in their favor.

In the meantime, the newly passed general part of the Tax Code co-exists with old laws on individual taxes, which often creates mismatches and confusion. Faced with the political reality of Duma opposition to Part II of the Tax Code, successive governments since late 1998 have not attempted comprehensive tax reforms, opting instead for piecemeal changes, often in the form of “emergency packages.”

For most of this period the declared priority was to reduce the tax burden upon domestic producers, whereas the actual steps were clearly prompted by pressing needs to increase revenue collection. For example, the government announced its intention to reduce the VAT rate, while simultaneously compensating regional governments, which would face a revenue shortfall in case of such a reduction, by allowing them to levy regional sales taxes. Subnational units have indeed broadly introduced such taxes, although the federal government’s reduction of the VAT rate was long delayed.

This is an illustration of the inconsistency of the Russian tax reform, where earlier declared goals are often superseded by short-term fiscal needs. Such inconsistency further contributes to the perception of the Russian tax system as one that lacks credibility and is subject to unpredictable changes. Worse yet, even Part I of the Tax Code, during the less than one year it has been in effect, has been amended frequently, mainly in order to strengthen the ability of Russian tax authorities to enforce revenue collection, and to weaken the protection of taxpayers’ rights initially stipulated by the Code. For example, the Code was recently revised to give the State Tax Police (STP) the authority to launch its own tax audits, which was earlier an exclusive prerogative of MinTax. Since the STP has broad powers in criminal investigation, and is no longer constrained by earlier checks and balances, this move is likely to put taxpayers at increased risk of harassment.

### **3. What's Wrong with the Present Tax System?**

#### **1) Federal Tax Policy and Administration**

Overall, after several years of fiscal reform efforts, the Russian tax system is still riddled with inefficiencies and fails both to collect adequate revenue for the government and to stimulate economic recovery and growth. The most notorious and damaging of the deficiencies that still persist are as follows:

- The total tax burden upon Russian firms often exceeds revenues left after immediate operational costs are paid. It deprives firms of the ability to invest, to pay dividends to shareholders, and to pay back debts to lenders. Often even fully compliant firms become delinquent, lacking cash to pay taxes due. This has become particularly common after introduction of the accrual method for VAT collection. The new rule made businesses suffering from non-paying customers unable to remit timely payments of the assessed tax.

- The combined tax on labor, which is the total of personal income tax and payroll taxes, amounts to over 60 per cent of gross payroll. This burden prompts businesses to go underground or to employ various schemes to evade taxation of compensation for personal services.

- The enterprise profit tax (EPT) does not allow deductions of such legitimate business expenses as advertising, interest charges (which are high in Russia's unstable macroeconomic environment), R&D, and personnel training. In addition, provisions for carry forward of losses are unduly stringent, while the allowed depreciation rate is too small and the amortization schedule inefficient and cumbersome.

- The VAT tax, despite some reforms, still includes features that are anomalous and burdensome for Russia—e.g., construction costs can not be credited—and imports from CIS countries are valued at an origin rather than destination basis.

- Russia still features antiquated turnover taxes; although nominal rates of these taxes are low, they could leave a taxpayer who is running an otherwise reasonably profitable business, with little or no profit.

- The number of taxes remains high, which makes fulfillment of filing requirements costly, especially in view of the fact that in addition to numerous taxes payable to the Ministry of Taxation, there are four payroll taxes that are collected by different agencies.

These deficiencies of the Russian tax system are compounded by the following serious weaknesses and failures of tax administration.

- There are counterproductive interdepartmental barriers between the Ministry of Finance (MinFin), which is responsible for evaluating tax policies and estimating actual and needed revenues; MinTax, for formulating and implementing these

policies; the STP, for enforcing tax law; the Customs Committee; and the separate administrations of the four payroll taxes.

- MinTax is not sufficiently in control of its regional units, which are *de facto* heavily dependent on regional and municipal authorities. The dual allegiance of regional tax offices hampers tax collection, because under the prevailing intergovernmental fiscal system, regions bear the full tax burden while keeping only a portion of the corresponding revenues, and have incentives to fulfill their own revenue goals before transferring remaining revenues to the center.
- Tax information is not sufficiently centralized, and, in particular, databases stored at local tax offices are not integrated into a nation-wide database. This makes it difficult, for example, for the tax authorities to match personal income tax returns with information filed by payers for personal services. As a result, not only income from the informal sector evades the taxman, but underreporting of formal sector compensation could also go undetected. Another obstacle to enforcing taxpayer compliance is the absence of a Russia-wide system of taxpayer identification numbers. The Pension Fund—the most important of the four payroll taxes— already has such a system in place, but MinTax is in the process of developing a separate system for its own needs.

Larger taxpayers still enjoy the privilege of negotiating their tax payments, which is essentially a continuation of the Soviet tradition of soft budget constraints. But while tax agencies are routinely failing to enforce the tax law in an efficient and impartial way, they are often used to enforce tax payments in specific cases for the purposes of political pressure and intimidation.

## **2) Intergovernmental Fiscal Relations**

The state of Russia's intergovernmental fiscal relations raises serious concerns. Despite considerable effort and some recent improvement, Russian fiscal federalism still fails to meet the criteria of clear and consistent expenditure and revenue assignments, accountability, and efficiency: these failures breed political tensions and lead to massive economic losses. The Russian tax system remains *de jure* excessively centralized, in sharp contrast with the profound *de facto* decentralization of economic and social policy resulting in part from the broad shift of expenditure assignments from the federal to the regional and local levels. Concentration of decision making over taxes at one level of the government, and expenditure responsibilities at the other, strongly distorts fiscal incentives.

Another serious problem of Russian subnational public finance is the profound interregional disparities in income and the level of public services, which call for equalizing transfers to regions. In the early 1990s horizontal and vertical imbalances at the regional level were somewhat alleviated by negotiated adjustments of sharing rates of federal taxes. This questionable practice was later abandoned, and at present equalizing transfers to regions are formula-based and paid out of the special Fund for the Financial

Support of the Regions (FFSR). While this reform was a major step towards the efficiency and transparency of intergovernmental fiscal relations, it has failed to reduce interregional fiscal disparities to an acceptable level. This is partly due to insufficient resources in the FFSR, and partly because the formula that is used for calculating transfers does not capture numerous (and often non-transparent) channels for resource flows between the federal and regional budgets.<sup>4</sup>

While in the fiscal relations between the federal government and Russia's 89 regions discretion is being gradually replaced by rules, Russian tax law does not provide clear and rational guidelines on the allocation of revenues and expenditures between regional and municipal governments. The existing federal legislation on this matter is ambiguous and sometimes contradictory (e.g., the Tax Code characterizes the real estate tax, to be introduced in the future, as a regional one, whereas other federal legislative acts sanction experiments with this tax at the municipal level). Intraregional fiscal relations are commonly regulated by the regions themselves, and *ad hoc* decisions passed by regional authorities continue to dominate the allocation of revenues and expenditures between regions and localities. As a rule, regions do not have the professional capacity required to develop an efficient intraregional system of public finance, and for lack of better ideas often copy the fiscal arrangements between the federal center and the regions. Just as portions of federal taxes are kept by the regions, those portions in turn are further subdivided in negotiable proportions between a region and its municipal units. Another often-cited explanation of the prevalence of sharing tax revenues between regions and municipalities is that municipalities do not trust the funding commitments of the regional

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<sup>4</sup> Following the breakup of the former Soviet Union in the early 1990s, the federal government progressively transferred certain responsibilities from the center to the oblasts and by the mid-1990s started devising formulae for making transfers to supplement certain taxes—such as PIT, EPT, VAT and excise duties? that were either fully assigned or shared with the oblasts, municipalities and raions. The assignment or sharing of these taxes among the federal, oblast and local level governments has been changing every year. The formula for transfers from the federal government's FFSR first came into force in 1995 and aimed at equalizing per capita budget revenues of regions and compensating them for the deficit if the equalization amount did not allow a region to cover the estimated basic expenditures. Under this arrangement, some powerful regions successfully negotiated with the federal government "deals" on the amount of FFSR transfers, using the threat of retaining some of the federal taxes that they had collected in the regions. To remedy the situation, the federal government developed a new approach in 1998 to these FFSR transfers based on the estimation of an indicator of fiscal capacity of a region, using the adjusted Gross Regional Product (GRP) indicator. This indicator is then weighted by the coefficient of expenditure needs based on regional characteristics such as the level of expenditures required to pay for basic social needs (health, housing, education). The FFSR is then distributed on the bases of the ranking of weighted per capita expenditures until the Fund is used up. So far, because of the lack of necessary data, only a simplified version of this formula is being used.

authorities: they perceive entitlement to a portion of locally collected federal taxes as a more credible source of revenues.

This approach, however, inevitably leads to profound fiscal inequalities, reflecting the uneven allocation of tax bases across municipalities. These inequalities, in turn, are addressed by intraregional equalizing transfer systems, which are often modeled after their federal-regional prototype. However, transfers, making up—partially or fully—for a lack of revenues from municipally earmarked taxes, undermine local incentives for revenue collection. This incentive problem is further aggravated by the fact that locally collected taxes are shared between two or three levels of government, whereas the burden of taxation is borne locally in full.

Another consequence of the lack of rules and transparency in intraregional fiscal relations is a tendency to overspend, which in turn tends to put fiscal pressure on the Federation government. Both regional and municipal governments are faced, on the one hand, with enormous demands from their residents to support social services, subsidize failing industries, and provide basic needs (housing, heating, transport) for the population. On the other hand, they face a soft budget constraint, arising from a system that to some extent rewards higher expenditures at subnational levels of government with increased transfers from the next higher level, *de facto* permits borrowing by subnational governments, and allows for the existence of various mechanisms (arrears, mutual offsets of arrears, and noncash transactions) for avoiding cash payments of liabilities. These tendencies lead to overspending by subnational governments and consequently increased demands for transfers (direct or indirect) from the Federation government. They also lead to reliance on various other fiscal devices, such as extra-budgetary revenues (see below).

These problems of regional fiscal management are compounded by the fact that the region's own (i.e., unshared) tax base is quite small. Out of 28 taxes allowed by the Tax Code (plus the four payroll taxes collected as contributions to social funds), regions and municipalities can on their own levy twelve, but most of these are insignificant, e.g., local licensing fees, gambling and inheritance taxes. Subnational taxes of the highest yield are various property taxes, which in 1998 contributed less than 12% of the revenues of regional and local governments. The bulk of subnational revenues come from so-called “regulating” federal taxes, which are shared in certain proportions between the center and regions. Sharing rates were initially set separately for each region, and later have been made uniform across the regions, subject to changes from one year to another as provided by annual federal budgets.

This system means that regional governments have little discretion and control over their main sources of tax receipts. The existing system also complicates revenue forecasting at the regional level, because sharing rates could be changed by the center. This practice also complicates federal budgetary planning, especially since decisions about sharing rates require painstaking bargaining with regions, given the fact that budgets must be approved by the Federation Council (members of this, the upper house of the national legislature, are chosen directly by the regional governments).

Overall, regional governments are restricted in their ability to reconcile revenue collection and fiscal needs with tax burdens upon local businesses and residents. Being unable to perform this critically important function within the official set of rules, regions resort to various surrogates of fiscal management, such as discretionary enforcement of federal tax collection or introducing regional taxes disguised in the form of regional “extra-budgetary funds.” The latter are usually exempt from the normal budgetary scrutiny and oversight, creating ample opportunity for corruption and abuse. Indeed, such devices undermine efforts to introduce greater transparency, accountability, and democratic process into the fiscal system at all levels of government.

In general, it is the view of the evaluation team that the present system of sharing taxes creates disincentives for regional governments to take steps to make their economies more efficient, and discourages the collection of those taxes that are passed on to the Federation government.<sup>5</sup> Nevertheless, it must be acknowledged that the evaluation team’s view that this system urgently needs to be reformed is not fully shared by all Russian fiscal experts, including leaders of the GSU team, and a few qualifications should therefore be mentioned. First of all, it can be argued that there are, after all, a number of countries where shared taxes are successfully collected and distributed—e.g., in Canada, Germany and in some subnational jurisdictions in the United States (for instance, between a state and its counties). Against this, it could be noted that Russia lacks many of the characteristics of these other countries that may be necessary to make such systems work—such as an honest civil service, the rule of law (including a reasonable degree of taxpayer compliance), a stable and infrequently changing structure of taxation, efficient budgetary management, and national political parties that create a community of interests shared by governments at different levels. A further argument for the present tax sharing arrangements is that they represent a hard-won compromise between the Federation and regional governments, a compromise that would be politically very difficult to renegotiate. While this is certainly true, it does not necessarily negate the proposition that a system of “own taxes” at each level of government should be accepted as an eventual goal, with intermediate goals of improving “own sources” of revenue for localities and regions, and reducing the excessive level of total taxation (both shared and unshared) on enterprises.

#### **4. Impediments and Constituencies for Future Reforms**

The Russian tax system is widely criticized both for its inability to generate sufficient revenues for the government, and for placing an excessive burden upon taxpayers. Future reform efforts should address the well-known deficiencies and failures of the present system. The main problem at the moment is not so much the *substance* of the necessary reforms, but their consistent *implementation* under the existing economic and political conditions in Russia.

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<sup>5</sup> For a more detailed discussion of this point, see Shleifer and Treisman, 1999.

Successful implementation, in turn, requires coordinated actions of the involved government agencies, consent of the legislature, and adequate taxpayer compliance. The first of these requirements is a necessary condition for the various functional units of the government to sufficiently communicate and cooperate with each other, so as to determine a tax burden is commensurate with expenditure needs, to assign taxes rationally between levels of government, and to administer tax collection efficiently at all levels of government. The second requirement calls for an ongoing dialogue between the executive and legislative branches over fiscal policy issues; such dialogue is required not only when draft laws are submitted to the parliament, but also when future legislative initiatives are being discussed and drafted. Finally, taxpayer compliance could be expected when the tax system is perceived at the grassroots as fair, transparent, and serving the interests of the society—i.e., as equitably distributing the tax burden and serving to provide an adequate level of basic government services.

All of these prerequisites of a successful tax reform have been violated in Russia. As explained earlier, the functions of tax administration are divided among no fewer than seven different agencies, each with its own agenda, bureaucracy, network of regional offices, procedures and database. Attempts to consolidate these services under a single umbrella have been unsuccessful. Instead, for example, the social funds have been struggling to shift the task of reducing payroll taxes onto each other. To further complicate the problem, policy coordination is not assured even within individual ministries. Finally, there are persistent and profound policy disagreements between the federal government and regions; this incongruity is particularly damaging, given the fact that federal and regional revenues hinge upon the same set of taxes.

Another fiscal problem impinging on tax reform is the non-transparency of a large part of budgetary expenditures, as well as that of extra-budgetary revenues and expenditures, which are apparently large (at all levels of government) but only partially known. Further non-transparency results from tax expenditures and the toleration of tax arrears and surrogate payments, which are forms of disguised subsidization. Reforms of budgetary and expenditure control procedures—such as the establishment of the Treasury system—have been pursued separately from tax reform measures, and have met strong opposition both from parts of the Federal government (especially the military) and regional governments. Yet, in a democratic, market-oriented civil society, explicit and transparent budgeting of all government expenditures is essential. Without such practices, national and regional legislatures, and through them the general public, are unable to weigh spending priorities or to assess tax policies in the context of the government's ability to fund public goods and social programs.

An immediate obstacle to tax reform has been the fact that prior to August 1998, and to some extent afterwards also, the government has been preoccupied with short-term political and economic goals, and has had broad access to borrowing both at home and abroad. These factors have reduced the perceived short-run need for a comprehensive tax reform. Besides, such a reform would have been a threat to the delicate political compromises that the government was negotiating. From the spring of 1998 until the fall of 1999, Russia was under a revolving-door type of governance. A succession of five

cabinets in less than a year and a half further shortened the already limited time horizons of most politicians and made it virtually impossible to coordinate and sustain tax reform initiatives.

Characteristic of much of the tax reform efforts in Russia to date has been disregard of the importance of reaching an operational consensus between the major stakeholders. The key stakeholders on the tax reform issues are the Federation Ministries of Finance and Taxation, offices in charge of social programs and safety nets, both chambers of the Federation legislature, regional authorities, and last but not least, the business community and the general public. That little or no attempt was made to reach a consensus among these stakeholders over the first draft of the Tax Code was an important factor contributing to its initial rejection and to the eventual failure to pass the second part of the Code. When the government has been successful in enacting tax laws and policies without stakeholders' support, compliance has been problematic, because taxpayers do not view the official rules and requirements as serving their interests. This attitude reinforces customary tax evasion, making it a pervasive social norm.

Closely related to this poor track record on consensus-building is a lack of clarity among the respective roles of the executive, legislative and judicial branches of government. There is still only rudimentary understanding in Russia of the notion of checks and balances among branches of government, and between the central government and other political forces, such as local and regional government and civil society. Yet these institutional features would be fundamental to the process of developing the broad consensus required to carry out sustainable fiscal reform.

In particular, a severe impediment to consensus-building has been the fact that until now the executive branch of the federal government has operated in a virtually permanent confrontation with the federal legislature. This has been an especially severe obstacle to fiscal reform, given the central role of the Russian parliament in making tax and expenditure policy. Relations between the legislative and executive branches have been further complicated by the emergence of the Federation Council as another key player, representing the interests of the regional administrations.

The political system that exists in Russia has so far been unable to adequately articulate broadly based social preferences regarding tax policies. Instead, the Russian parliament has been an arena for the advancement of various special interests, quite often detrimental for overall economic and fiscal efficiency. Budgetary hearings and discussions of draft laws have been dominated by attempts to win tax concessions and exemptions for particular industries, regions and groups. For example, attempts of the Russian government to eliminate the blanket tax exemptions given to former R&D centers of Soviet military-industrial complex, known as ZATOs, have met strong resistance in the parliament. These exemptions, arguably intended to provide fiscal stimuli for depressed territories, were in reality used for multibillion-dollar tax avoidance by a wide range of companies. Successful lobbying of narrow interests for preferential tax treatment feeds the public perception of the Russian tax system as unfair and capable of being manipulated by special interests.

Russia differs from mature market democracies in that most voters do not view tax policy as an important political issue. Social indifference to taxes is in part a legacy of the Soviet era, when all taxes were nominal and withheld at source; partly a reflection of widespread poverty, because of which legally paid incomes, if any, are taxed at a low rate; partly the result of the perceived inequity of the tax burden; and partly evidence of an immature civic culture. In these circumstances, where can one find a constituency that is sufficiently broad and empowered to form a political base for efforts to build an efficient tax system in Russia? There is growing evidence that such a base could be found in the Russian business community.

Russian businesses have come to see the current tax system as the main impediment to commercial activity. Oppressive taxation is now ranked ahead of such obstacles as predatory bureaucracy, inefficient corporate control, poor enforcement of contracts, and inadequate protection of property rights. Businesses are protesting not only the tax burden *per se*, but also the damage it causes indirectly. Firms operating in the underground economy acquire a competitive edge against legitimate businesses, forcing the latter to resort to shadow activities, or to move activities offshore, as a means of economic survival. Underground operations raise administrative and transaction costs for Russian business. Walking the tightrope of dubious “tax optimization” schemes increases legal risks, precludes seeking dispute resolution and contract enforcement through official institutions of commercial arbitration and court of law, and leaves firms vulnerable to extortion by corrupt officials and the criminal underworld. Widespread tax evasion hurts the transparency and accountability of Russian firms, making it more difficult for them to raise investment capital. All of the above shortcomings dramatically reduce the outlook for Russia’s economic growth.

Since the 1998 economic crisis, the Russian business community has become increasingly assertive in raising its voice for a better tax system. Several factors have contributed to this. First, the crisis has undermined what was known as the Russian economic oligarchy, centered around the nations’ finance and extracting sectors, which earlier dominated the economic and political scene. Powerful economic and financial groups were less interested in efficient and fair taxation, being able to use their clout to reach satisfactory exclusive arrangements with the government. In fact, an excessively burdensome and non-transparent tax system was not just tolerated, but favored by the “oligarchs” as providing excuses for tax delinquency and opportunities for manipulation.

Second, the crisis, because of the resulting ruble devaluation, has been a boon for the heretofore moribund Russian manufacturing sector, where market power is much less concentrated than in natural resources and banking, and which would be the primary beneficiary of an improved tax system. Economic empowerment of Russian manufacturers enables them to articulate more strongly their policy preferences, and businesses increasingly view themselves as a counterpart in future tax reform debates. Third, the 1998 default on Russia’s public debt put an end to lucrative speculation in government securities, and raised the relative attractiveness of industrial production and industrial investments. The four-fold devaluation of the ruble has created broad

opportunities for import substitution, and highlighted the strangulating effect of the present tax system.

These developments may increase Russia's openness to TA in the field of tax (and more broadly fiscal) reform. Another important factor will be the recent State Duma election, and the expected election of Acting President Putin. Leading Russian politicians have recently suggested that these developments may eliminate much of the recent political gridlock and speed previously impeded reforms.<sup>6</sup> At the same time, 1999 saw a sharp deterioration of Russia's relations with the West, and anti-Western sentiments have quickly spread throughout the political elites, trends not helped by the politically motivated delay or suspension of earlier negotiated bailout packages from the IMF and other donors. Thus, while reform may now be facilitated, Russian counterparts may be less receptive to Western advice. Nevertheless, particular counterparts may have strong incentives to use Western expertise on a selective basis.

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<sup>6</sup> These views have been expressed in recent Op-Ed pieces by Sergei Shoigu in the Washington Post and Boris Nemtsov in the New York Times.

### III. The GSU Program: Output, Activities and Impact

This section of the report will describe the expectations of the GSU contract and present the evaluation team's findings with respect to GSU's performance.

GSU's contract stipulates that it provide "advisory, analytical, and training services" in five main areas:<sup>7</sup>

- *Tax Policy/Legislation*: helping with the preparation of tax policy legislation, as well as implementing procedures and regulations, at the federal and regional levels;
- *Tax Administration*: assisting the (then) STS to improve tax administration by introducing a system of taxpayer registration and monitoring, better audit procedures, and the training of staff for large-case tax inspection and general tax administration;
- *Economic Analysis*: improving existing models of analyzing the impact of tax legislation; and
- *Intergovernmental Relations*: improving intergovernmental fiscal relations by formulating policies for assigning fiscal responsibilities to federal, regional and local governments.
- *Property Taxes*: continuing the previous experimental real estate tax project in Novgorod and Tver.

The contract establishes the following specific desired results (benchmarks):

- *Tax Legislation*: the enactment of a new tax code, consolidation of income and other payroll taxes, a full shifting of VAT to accrual accounting, enactment of a nationwide law for municipal taxes, and reduction in the filing costs of taxpayers;
- *Tax Administration*: organization of the STS along functional lines and division of responsibilities among tax agencies, improved audit procedures, substantial reduction in taxpayer arrears, holding at least 12 seminars at State Tax Inspectorates and for six groups of arbitrage court judges, and initiation of training activities to support the implementation of property tax;
- *Economic Analysis*: institutionalization of capacity within the MinFin for estimating the revenue impact of proposed legislative changes, improved tax compliance, and various economic developments;

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<sup>7</sup> References here are based on USAID Contract No. 118-0009-98-063, subsequently referred to in this report as "USAID/GSU Contract."

- *Intergovernmental Relations:* enactment of legislation governing the financing of sub-national governments; and
- *Property Taxes:* Replacement of existing property taxes with a consolidated municipal real estate tax, and clear demarcation of the revenue-sharing relationship between the three tiers of government.

This fiscal reform program falls under USAID/Russia's Strategic Objective (S.O.) 1.4, "improved economic infrastructure to support market-oriented growth." The Mission's expectation is that the project will contribute to the development of "a rational tax system, fostering market-driven decentralized growth and meeting the needs of a modern economy."<sup>8</sup>

Of course, the attainment of such goals and targets is strongly influenced by exogenous events, which the contractor can neither anticipate nor control. Consequently, this Section first discusses some of the major unforeseen developments that influenced outputs or the impact of those outputs. It will then examine the contractor's performance for the project's five technical components in terms of the plans and targets articulated in the USAID/GSU Contract and subsequent GSU Work Plans.

Briefly, the key environmental factors influencing GSU's work, some of which have been described in the previous section, included the following:

- *Economic Deterioration:* The continuing deep recession of the economy created a climate of declining revenues and rent-seeking, with a tendency for all stakeholders to prefer short-term stability over the possibility of long-term improvement.
- *Frequent Changes in Political Leadership.* The appointment of four new Prime Ministers since the spring of 1998<sup>9</sup> generated a discontinuity in the leadership of the government departments (GSU counterparts) engaged in carrying out fiscal reform.
- *Organizational Dysfunction.* The creation in 1998 of a Ministry of Taxation, with a delineation of functions insufficiently clear from those of the Ministry of Finance, resulted in uncertainty as to their respective roles.
- *Financial Crisis.* The emergency fiscal measures adopted in response to the August 1998 financial crisis took priority over the timing and sequencing of GSU's program.
- *Elections.* Impending parliamentary elections (in late December 1999) further slowed down the momentum of reform efforts, especially during the latter part of 1999.

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<sup>8</sup> USAID/GSU Contract, p. 2.

<sup>9</sup> In the spring of 1998, Chernomyrdin was replaced by Kiriyenko, who was in turn replaced in the fall by Primakov. Eventually, in 1999, Primakov gave way to Stepashin, who was then replaced by Putin.

- *Lack of Qualified Counterparts.* Abysmally low civil service salaries—even for top-level, highly qualified and experienced advisers—resulted in the loss of already scarce experienced and properly trained Russian technical staff in counterpart agencies, thereby limiting the contractor’s ability to transfer skills.

In addition to these environmental factors, GSU project managers also faced several problems related to its USAID contract:

- *Reduction in Funding.* The budget for the project was originally set at \$15.35 million for the first two years, with the possibility of extension to \$19.97 million for a third year. Subsequent Congressional action, in response to Russian arms sales to Iran, required 50% cuts in USAID assistance to the Russian government. Because of the high priority attached to the tax reform project, and despite its heavy concentration in assistance to government agencies, it was not cut by 50%, but it was still necessary to reduce its funding. In December 1998, USAID notified GSU that the budget for the project was set at \$10.6 million through 12/17/99; an additional \$321,000 was eventually made available for the project extension through 3/31/2000.
- *Troubled Relationships with Other Projects.* In 1998 GSU was faced with the task of not only initiating its own work but also coordinating the work of two other U.S. TA providers, Barents and the U.S. Treasury, both of which were already on the ground working and neither of which welcomed the idea of having to coordinate their work with a newly arrived contractor. (For more on this point, see sub-section III, pages 24-25 below.)

The following subsections review GSU's activities in the five principal areas of its work: tax policy, economic analysis, tax administration, intergovernmental fiscal relations, and property taxes. This subsection ends with a brief overview of contractor performance.

## 1. Tax Policy

The major problem for Russia’s tax policy, recognized by GSU at the time of submitting its contract proposal to USAID, was a need to revise tax legislation through enactment of either a comprehensive Tax Code or of separate laws on each major tax. The goal of such revisions was a tax structure more conducive to the growth of the economy, more equitable in distributing the tax burden, and better able to generate revenue. There is a broad consensus among experts on the Russian tax system that to achieve these goals, a revised tax structure would need to:

- Remove distortions in the existing tax system caused by excessive exemptions;
- Widen the tax base;
- Correct numerous anomalies, e.g., allowing deductions for all legitimate business costs in calculating the enterprise profit tax (EPT) and value-added tax (VAT);

- Lower tax rates, and
- Simplify the prevailing system of numerous taxes (which causes immense administrative burdens for taxpayers).

The contract with GSU specifies that the contractor assist in preparing alternative legislation covering critical areas of taxation (such as VAT, integration of personal income and payroll taxes, natural resource taxation, excises, and trade taxes); in preparing transition rules needed to support implementation of the Code; possibly in revising the small business tax law; and in developing general and technical explanations of the Tax Code and specific laws.<sup>10</sup> Benchmarks for this effort would include: adoption and/or implementation of a new tax code; reduction in taxpayer cost of filing; consolidation of income and other payroll taxes; nationwide authority for municipal property taxes; and full shift to accrual accounting for VAT.<sup>11</sup>

GSU's main work in these areas was with MinFin, to a lesser extent with MinTax, and with the Budget Committee of the Duma. Its work with the Duma was a particularly innovative and successful aspect of the project. When the Tax Code prepared by the Ministry of Finance and STS with GSU assistance came up for discussion in the Duma, Duma delegates opposed to the Ministry's draft submitted ten alternative versions of a Tax Code. With the help of numerous calculations prepared by GSU (under the Economic Analysis component of the project described in the next subsection), as well as other GSU analyses and comparisons with international examples, the government was able to demonstrate the superiority of its own proposal. The Duma passed this version of the Code, but only Part I of the Code was ultimately enacted. Duma opposition to Part II of the Code can be explained partly by the sheer obstructionism of anti-government parties. Some observers also believe that the legislation was too long and detailed to be digested by Duma members in one package. The government's comprehensive version also faced opposition from several special interest groups whose favored position under existing legislation would have been threatened.

Faced with this political reality, the Russian government decided to pursue reformed tax legislation on a piecemeal basis. GSU assisted in the drafting of such legislation on the Personal Income Tax (PIT) and the Enterprise Profit Tax; participated in meetings, discussions and debates on these taxes; and provided verbal and written comments and data on their revenue impacts for use during the Duma debates. The advice provided by GSU also included legislative and economic analysis, information on best practices, and international comparisons. Tax policy advice was also extended with respect to other types of taxation that were not subject to comprehensive reform but for which modifications were considered by the Duma—for instance, VAT, excises, sales tax, and taxes on natural resources. Another important focus of GSU's work was helping to improve Part I of the Tax Code, both during its passage and the subsequent process of its amendment.

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<sup>10</sup> Ibid., pp. 10-11.

<sup>11</sup> Ibid., p. 14.

In addition, GSU provided comments on the emergency revenue measures in the aftermath of the August 1998 financial crisis, on the “19 Law” Package to Support the 1999 Budget, and on the package of bills to support revenue for the 2000 budget. For the Ministry of Finance, GSU also reviewed the revenue implications of a proposed reduction in the top personal income tax rate to 30 percent and of the possible elimination of turnover taxes. In regard to specific assistance on selected tax policy matters, the GSU prepared papers to address such issues as the treatment of depreciation within the EPT, the tax implications of transfer pricing, and the reorganization and liquidation of enterprises.

GSU also arranged useful training for government officials, and that training may contribute to reform over the longer-term. Training included study tours to Canada for Duma members on the retail sales tax and to the United States for Duma members and senior officials from the State Tax Service and the Ministry of Finance on enterprise profits and capital markets taxation. In its Exit Strategy Workplan, GSU had envisaged holding roundtable discussions late in 1999 among senior government officials who had participated in these programs, but these could not be held because of time constraints and the imminent Duma election.

A variety of specific project activities and outputs noted above, including policy studies, assessments, analyses and recommendations, were useful to government officials and legislators and contributed to real accomplishments. These project outputs, along with those of other TA providers, played a significant role in achieving several important improvements to the tax structure. Noteworthy achievements include the harmonization of the top rate of individual income tax and enterprise profits tax at 30 percent; the extension of VAT rebate on capital construction costs (in a legislative amendment now awaiting Presidential approval), and the strengthening of arbitration and appeals procedures. The usefulness of GSU’s efforts is also reflected by the fact that senior officials of the Ministry of Finance and the State Duma indicated their desire to have the project extended by another year—assistance that these officials regard as important to the achievement of further reforms in the forthcoming session of the newly-elected Duma.<sup>12</sup>

To measure the impact of TA on tax policy, a possible test—and a benchmark of the USAID/GSU contract—is legislation enacted. For a variety of political and other reasons, most of the legislative initiatives to which the GSU contributed have not yet been enacted. Thus, while the tax policy component of the project had some notable achievements, the overall results in terms of significant legislation have still been rather limited.<sup>13</sup> Nevertheless, this conclusion should be viewed in context: the goals were very ambitious, particularly for a two-year project, and the environment (as indicated above) was not propitious. Moreover, the advice provided did succeed in preventing harmful legislation from being adopted, and the TA did improve the awareness and understanding

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<sup>12</sup> This view was indicated both in interviews with the evaluation team and in letters sent to USAID/Russia.

<sup>13</sup> This is a matter where judgments could differ: some of those interviewed feel that the passage of Part I of the Tax Code, and additional legislation since mid-1998, represent substantial progress.

of Russian counterparts of what constitutes good tax policy. Finally, it is the Russians, not the project nor USAID, who must bear primary responsibility for the failure to implement more substantial reforms during this period.

In trying to determine whether and how the project might have been more successful on tax policy reform, the evaluation team interviews yielded a number of comments on the project that might be useful in planning future work:

- *Involvement of the private sector.* Several respondents suggested that the project did not appear to make a sufficient effort to engage the Russian private sector in the discussion of the draft tax legislation. The private sector's involvement might have helped to establish consensus on the objectives of the tax reform and the need for reasonable compromises, as against the narrow electoral interests of legislators. Recently, the private sector itself seems to have taken the initiative in getting involved, organizing a tax advisory group under the chairmanship of the Deputy Minister of Finance.
- *Turn-around time on analyses.* According to some Russian interviewees, the project's response time on technical questions raised by Duma delegates was too long, perhaps because of the need for Russian-English translations and for consultations between the Moscow and Atlanta offices of the project. However, other interviewees reported that the deadlines for response set by the Duma were sometimes extremely short. And the limited resources of the project—given its heavy workload, many emergency requests in 1998, and the diversity of tasks—should also be borne in mind.
- *Coordination with non-U.S. technical assistance providers.* While the project team worked closely with some donors like the IMF and the World Bank, their coordination with other donors was limited, though initial efforts to collaborate were made by GSU. (See discussion in following sections.)
- *Writing for the audience.* Finally, a few Russian interviewees commented that GSU's reports sometimes tended to be more academic than practical.

## **2. Economic Analysis**

The USAID/GSU Contract called for the contractor to “recommend, and assist in developing, suitable mechanisms for monitoring and projecting economic trends relevant to the tax system,” as well as assisting the Ministry of Finance with refining and maintaining revenue forecasting models, and helping the [then] STS “in implementing standard methodologies for data collection and reporting.”<sup>14</sup>

The main thrust of GSU's work on this component focused on the need to update and further develop several fiscal analysis models created by Barents. The GSU team envisioned applying these models in the analysis of tax policies, the formulation of

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<sup>14</sup> Ibid., pp. 12-13.

realistic budgets, improvements in fiscal management, estimates of the impact of macroeconomic changes on the government's ability to generate revenue, analysis of intergovernmental relationships, and the evaluation of the progress of a new system of property taxation.

The basic models prepared by Barents and further developed by GSU were:

- A personal income tax model (PITM), a micro-simulation model based on an extensive database of Russian households;
- An enterprise profit tax model (EPTM), based on aggregates representing different firm sizes and groups of industries;
- An indirect tax model (ITM), covering the VAT, and excise and sales taxes, based on an input-output table of about 25 industries that is customized to serve the needs of tax revenue estimation;
- A tax receipt monitoring model (TRMM), intended to compare actual tax receipts with earlier trends and projections, and

In addition a macroeconomic input-output model was developed by GSU jointly with the "Expertech" group from the Institute of Forecasting the National Economy, based on the last officially released input-output table of the Russian economy, dated 1992.

GSU carried out work on the updating and further development of these models both through hands-on cooperation between its resident Economic Analysis Team (EAT) and the Russian counterparts in the MinFin and through short-term visits of experts. U.S. Treasury experts also collaborated in a few of these activities, as did personnel from think-tanks like the Institute for Economies in Transition (IET) and the Russian European Center for Economic Policy (RECEP).

GSU utilized the first four models mentioned above to provide Russian officials and Duma delegates with estimates of the impact of numerous tax policy proposals. The simulation models also enabled the GSU team and its Russian counterparts to calculate the impact of proposed revenue measures, including year 2000 revenue proposals. As noted above, the GSU team provided estimates of the impact of reducing the top marginal rate of individual income tax to 30 percent, of change in the VAT, and of eliminating some tax exemptions. In response to specific requests from regions, the GSU team also used the PITM to assist the Department of Economy and Forecasting, the Nizhny-Novgorod Oblast Administration, and the Governor of Yamal-Nenentsky Autonomous District.

Unlike the first four models listed above (which are basically arithmetical calculations based on accounting identities and the extrapolation of historical relationships between variables), the macroeconomic model was a large (over 400-equation) econometric model capable in principle of estimating the revenue impact of a particular proposed tax policy

change. The evaluation team was informed by the key Russian counterpart that this model was used only once for the project—for a 1999 compliance study that generated projections of indirect tax collections and compared them with projections based on the simpler Indirect Tax Model. Given the obsolete and unreliable data used in this estimation, the Russian counterpart considers such a model useless for projections at the present time, and the evaluation team agrees. It can be argued, however, that such a model constitutes a kind of capital asset, a shell that could be filled with more recent and reliable data when they become available.

GSU's proposal to train up to 25 Russian counterpart staff in the maintenance and operation of this model could not be fully implemented. GSU efforts were limited by the same constraint as confronted Barents—a lack of suitable Russian counterparts in the Federation government. As a result, there are apparently only five technicians who can handle these models in the Ministry of Finance, and the Ministry of Taxation has no such capacity. Nevertheless, the GSU team successfully transferred three of these models (EPTM, PITM and ITM) with manuals to MinFin specialists.<sup>15</sup>

In addition to work on these models, the GSU team devoted considerable effort to analytical studies on specific topics related to tax policy and administration. These studies, conducted in response to requests from senior government officials and Duma members, included the following topics:

- the tax burden on labor income (PIT and payroll taxes) in Russia, compared to other countries;
- the problem of tax exemptions in Russia's closed zones (i.e., the ZATOs described earlier in this report);
- VAT compliance rates in 25 countries;
- the prevalence of employee share ownership plans (ESOP) in selected countries;
- taxation of alcohol (control and monitoring, excise tax potential, reporting and estimation of revenues and consumption);
- fiscal analysis of the oil and gas industry (revenue estimates of proposals, description of the financial model, development of a financial model for the natural gas industry, taxation of low productivity oil fields, impact of new legislation on production share agreements, and the gasoline market);
- tax arrears and offsets;

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<sup>15</sup> Moreover, they have successfully transferred electronic versions of PITM, EPTM, ITM, TRMM and manuals thereon to staff of the Russian European Center for Economic Policy (RECEP).

- factors influencing revenue collection and
- taxation of capital.

In the face of the difficulties of getting Goskomstat to provide some necessary data, GSU seems to have produced high-quality models and analyses of tax policy matters. These served as valuable inputs into policy debates and formulation. Although the evaluation team's interviews revealed some criticism to the effect that GSU tended to stray beyond its own work plan into several other tax policy areas, the studies were client-driven and legitimate areas of tax policy, and more broadly, fiscal analysis. While GSU widely and usefully circulated research outputs from the project, certain papers done on request by the Ministry of Finance received limited circulation at the request of the beneficiary. This is regrettable, since, as already noted, the studies were of good quality and addressed important policy issues.

### **3. Tax Administration**

The GSU team carried out its work in tax administration in collaboration with USAID-financed projects implemented by Barents and the U.S. Treasury project. GSU's objectives, as stated in the USAID/GSU contract, were to assist the STS in reforming procedures for tax collection, appeals, and audit, and to work out training programs in the various functional areas.<sup>16</sup>

USAID's efforts to improve the administrative capacity of STS complemented planning for the World Bank's Tax Administration Modernization Project (TAMP), which will introduce new data processing methods and equipment. The ultimate objective of all of these programs is to lower administrative costs, increase productivity, and improve taxpayer compliance.

For the overall direction of this component of the program, the contractors established the Tax Administration Technical Component Coordination Group (TA-TCCG). The TA-TCCG consisted of a Resident Manager, five resident consultants and two other lead consultants. This Group was to work with the Federal STS, as well as with regional Tax Inspectorates, Tax Police and Customs service, in collaboration with the World Bank and IMF Resident Representatives.

The presence during the initial stage of the project of multiple TA providers with overlapping terms of reference in the tax administration area caused considerable confusion about roles and responsibilities. Both GSU and Barents understood that USAID expected GSU to pick up HIID's role of coordinating the work carried out by Barents and Treasury. However, this arrangement did not work in practice. Not only was there a lack of collaboration, but, according to several observers, the institutions undercut one another.

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<sup>16</sup> Ibid., pp. 11-12.

Tension between the TA providers distracted their managers and probably lessened the impact of the work being done. To resolve these problems, USAID asked the providers to attend a retreat in June 1998. This was a laudable attempt to resolve the problems, but the agreement reached at that time was not effectively implemented. In October 1998, USAID again intervened, this time redefining the roles of the GSU and Treasury so that each had separate areas of responsibility: Treasury took over all work in tax administration and phased out of most other areas; GSU phased out of tax administration and increased its work in other areas. This action seems to have resolved the problems.

GSU started implementing the project in early 1998, embarking on the formulation of a “blueprint for reform.” In its work plan GSU assumed primary responsibility for all of the tasks, except for a number of areas for which it designated Barents as support partners. This joint Barents-GSU work included: conducting arrears collection programs, optimization of arrears collection efforts, and development of audit selection; simplification of VAT processing and implementation of a registration threshold; development of VAT technical notes, new and simplified tax returns, invoices and sales and purchase journals; study tours; assistance with the VAT accounting system; assistance in the creation of a reference library; drafting of certain tax administration aspects of the Tax Code, such as a rationalized penalty and interest structure, enforcement provisions and elimination of non-tax related work from the Code; and finally, development and designing of return forms for VAT, EPT, PIT and withholding taxes.

In response to requests by MinTax officials, GSU carried out a series of studies in support of the modernization of STS. These studies were important, as they were a condition of continuation of the World Bank loan for computerization. A GSU team under the direction of Alan Firestone conducted detailed reviews of the Ministry’s nationwide organization and of its computer systems and training. It produced a lengthy report containing recommendations on a short-term as well as a long-term plan of action. In addition, GSU assisted STS’s large taxpayer unit by delivering several training programs on organization, management, and audit practices; producing manuals and reports for beneficiary users; and arranging study tours of its staff to observe similar units in Argentina and Peru.

The coordination problems of 1998 and the fact that GSU’s work in tax administration was halted after one year obviously complicate the task of evaluating performance and impact of this component. GSU did produce what appears to be a coherent and detailed action plan for a unified computerization system and for reorganization of STS on a functional (instead of by tax or by taxpayer) basis. The report seemed to be a useful blueprint for further work.<sup>17</sup>

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<sup>17</sup> According to some reports, the impact of this work may have been adversely affected by the GSU team’s difficulty in establishing rapport with key counterparts, e.g., the MinTax team (led by Deputy Minister Mishustin) responsible for the tax modernization project.

#### 4. Intergovernmental Fiscal Relations (IGFR)

Under this project element, GSU was first to prepare “an evaluation of the progress in Russia toward clear, objective, and appropriate assignments of revenue and budget responsibilities among levels of government” as a result of recent or pending legislation, and then prepare a workplan.<sup>18</sup> The resulting study was the widely circulated GSU paper by Boex and Martinez (1998, 1999). In the subsequent workplan, GSU proposed providing TA to the federal and regional governments for improving the mechanism and the bases for the provision of resources by the federal government to regions (oblasts) and by the oblasts to municipalities and raions. GSU assistance was to include guiding Russian officials in the technical assessment of legislative changes and budget formulation; conducting field visits to oblasts to assist in the measurement of revenue capacity and expenditure needs; writing technical papers and conducting workshops, and arranging study tours for key officials.

To promote reforms in these areas, the GSU team organized an Intergovernmental Technical Component Coordinating Group (IG-TCCG). This group operated under the leadership of Galina Kourliandskaia and included one expert each for pilot oblasts (see below).

With regard to federal-oblast fiscal relations, noteworthy activities and outputs included:

- GSU Consortium Director Dr. Jorge Martinez-Vasquez produced a comprehensive paper (in co-authorship with L.F. Jameson Boex) on *Fiscal Decentralization in the Russian Federation during the Transition* (1998,1999), as well as an in-depth regional finance report for the Leningrad oblast, and reports for other oblasts, which served to better define for federal policy makers problems at the intraregional level.
- The project’s IG-TCCG assisted the policy makers in the Department of Local Self-Government Department in the Presidential Administration (Trunov) and the Ministry of Finance (Lavrov) to improve the conceptual basis of FFSR transfers and to stabilize the assigned shares of the relevant federal revenues. This work has helped MinFin introduce an improved equalization formula at the federal level in the 2000 budget.
- The project prepared a document on “Methodological Guidelines for a Regional Intergovernmental Fiscal Reform Strategy,” which is expected to become the basis of government legislation in this area.
- For the Ministry of Finance, the IG-TCCG developed documentation detailing the revenue capacity methodology used for the regions and indexation of budget expenditures for the regions. This work is based on extensive research and the authors’ international experience and has been shared with the IET.

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<sup>18</sup> Ibid., p. 13.

- The project team prepared a regional-municipal database by interviewing 87 regional administrations on the composition of sub-national governments and contacting all of the 88 regions (excluding Chechnya). The data base contains data for 54 states for which information has been processed in the necessary format for the period 1995-98 in respect of budget execution, arrears, budget balance sheets, characteristics of social infrastructure, government employees and categories of population consuming particular government services.

With respect to regional-municipal relationships, the project assisted six regions: Leningrad, Tomsk, Novgorod, Vladimir, Rostov and Tyumen. These regions were selected for pilot work on the basis of their strong interest and political commitment to reform. GSU assistance included reviewing their budgetary situation according to international standards, analyzing their revenue capacity and expenditure needs, and collaborating in their legislative process. Work has been carried out primarily by and through Russian experts assigned to each of the pilot oblasts.

The evaluation team visited Novgorod and Vladimir to meet with oblast administrators. The team found their responses very positive. In Novgorod, the Chairman of the Finance Committee indicated that GSU's assistance in establishing fiscal capacity and expenditure norms was useful and could help to reduce arbitrariness in intergovernmental fiscal relations. Before accepting the proposed norms, officials noted that they wanted to better understand their financial implications and see estimates of the tax capacity for the 22 municipalities.

In Vladimir, the Deputy Governor indicated that the oblast had become interested in the interregional fiscal issues after attending a Ministry of Finance workshop in September 1998. Observing that regions that had done preparatory work benefited more from the FFSR transfers, oblast officials had decided to accept GSU's offer of technical assistance to supplement their own efforts to calculate tax capacity and to establish expenditure norms. Officials in Vladimir were most appreciative of GSU's guidance, mentioning specifically GSU's help in providing computer software and examining expenditure standards and norms.

The GSU team also arranged study tours for the Russian officials and conducted seminars and workshops in the pilot regions. Study tours facilitated Russian participation in an OECD sales tax seminar and in various World Bank seminars. Over the period May 1998 to October 1999, regional workshops and seminars were held in all six of the pilot regions. Officials from adjoining regions or expressing special interest in GSU's work were also invited to participate in these workshops. These workshops were well received and helped to disseminate the results of the IFGR program. Some observers questioned whether even greater dissemination of the results of the regional programs might have been undertaken.

In general, the evaluation team found very supportive comments from virtually all of the beneficiaries of their technical assistance in the regions. Officials of the Novgorod and

Vladimir administrations expressed regret at its discontinuation in the near future and asked the evaluators to convey their plea for its extension.<sup>19</sup>

As noted in Section II, the current structure of the tax system results in weak incentives at both the regional and municipal levels to collect taxes for transfer to the next higher level of government. A system of regional transfers to localities, based on the difference between the expenditure needs and actual tax collections of the municipalities, would institutionalize existing incentives for localities to practice “municipal protectionism” by shirking their tax collection responsibilities. To attack this problem, the GSU team concentrated its efforts on designing transfer systems based on the *fiscal potential* of municipal units. Apart from the methodological and logistical difficulties involved in assessing such potential, this approach still does not eliminate the incentive problem, because as soon as a particular indicator is chosen as a yardstick of fiscal capacity, there is every reason to expect that considerable efforts will be spent to manipulate this indicator’s calculations in the desired way. Aware of this problem, the GSU team proposed and evaluated alternative approaches to gauge municipal fiscal capacity, and has worked in the belief that despite the incentive problem, their approach—incorporating both client-based expenditure standards for public services and the fiscal capacity measure—does work toward establishing greater transparency, stability, and accountability in regional fiscal management.

The evaluation team, although respecting the views of the GSU experts, is less sure than GSU that such improvements at the regional level will eventually contribute to a more rational nationwide fiscal system. The evaluation team believes that there are fundamental flaws in the current system in which municipal administrations serve as tax collectors for regions and the central government. As mentioned earlier (see I.3), the evaluation team agrees—and in principle, the GSU team also largely agrees—with those students of the Russian fiscal system<sup>20</sup> who have suggested that a sounder system of intergovernmental finance would be based on taxes assigned wholly (without sharing) to different levels of government. Such a system might be accompanied by more decentralized responsibility for tax collection, with each level running its own tax collection system.<sup>21</sup> Such an implied increase in the fiscal autonomy of municipalities, plus transfers from higher-level governments to implement funded mandates, would render unnecessary the whole problem of estimating of municipal fiscal capacity. Of course, this would require a radical and federally legislated departure from the traditional approaches and would not be politically or administratively feasible in the short-run (see

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<sup>19</sup> A single interview with one official from Leningrad oblast suggested that the type of TA being offered might not always lead, in a broader sense, to improved intraregional fiscal relations. For instance, helping oblast governments calculate taxable capacity of municipalities may do no more than reflect different economic bases; and rather than help localities to develop their own tax base, it may be a futile attempt to create incentives to put local pressures on officials of the national tax service.

<sup>20</sup> See Shleifer and Treisman, *op. cit.*

<sup>21</sup> This is the pattern in the United States, like Russia, a large federal country. In some other countries, e.g., Canada and Germany, both state and federal taxes are collected jointly by the same government agency.

VI.2.k for further discussion of this point). Under such circumstances, the type of work GSU has undertaken in the regions seems to be a worthwhile use of TA resources, but its fruits will not become fully evident before more fundamental reforms have been carried out.

## **5. Real Estate Taxes**

Under the USAID/GSU contract, GSU was to complete the pilot projects in Novgorod and Tver started by CFED in 1995, to continue helping to develop “the federal and local framework and related impact studies, and to support drafting” of legislation related to municipal real estate taxes. GSU was also to prepare a work plan developing guidelines and procedures to be used in the pilot and to transfer knowledge to and carry out training in other cities, if adequate funding was available.<sup>22</sup>

GSU’s involvement with real estate taxes began about mid-April 1998, following the completion of the CFED contract. GSU used a local Russian subcontractor, CREA, whose Director, Natalya Kalinina, was effectively the GSU team leader. The objective of the real estate tax program was to consolidate Russia’s three property taxes—the land tax (payable by all land owners on the assessed value of their land); the enterprise assets tax (payable at the rate of two percent of buildings, improvements, inventories, machine and equipment and transport vehicles), and the individual real property tax or “tax on physical persons” (payable at various low rates on the value of apartments, dachas, garages and boats).<sup>23</sup> The logic of introducing a consolidated real estate tax was to increase local governments’ own source of revenues by capturing the high actual value of real estate; this tax would also shift the burden of existing excessive taxes on profits to visible and tangible wealth, and create incentives for the more efficient use of land.

GSU’s work in Novgorod and Tver, provided at both the federal and municipal levels, was initially intended to help officials to prepare and to send out tax bills to property owners by September 1998 for payment falling due in January 1999. GSU’s accomplished the following work at the federal level:

- Drafted and supported passage of national enabling legislation that provides appropriate timing and flexibility for local governments in implementing the market-value-based property tax (i.e., real estate tax) in pilot cities.
- Supported the Inter-Ministerial Working Group that coordinated the project at the federal level.
- Developed methodologies and systems (see below) that could easily be transferred to other cities.

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<sup>22</sup> USAID/GSU Contract, p. 14.

<sup>23</sup> The legality of these taxes derives from the federal Law on Basic Principles of Taxation, 1991, and later from Part I of the Tax Code.

At the municipal level, the technical assistance covered six areas. In five of these areas, work was in fact carried out:

- Developed a property (i.e., real estate) tax information management system (PTIMS) and assisting in the collection of data necessary to support the valuation and taxation structures other than buildings, thereby adding information on structures in Novgorod and cleaning up earlier work on the cadastre in Tver;
- Refined the valuation methodology mainly for industrial property, finalizing valuation methodology for Tver, and assisting in implementing an appeals process by preparing procedural material and training staff;
- Analyzed changes in the expected tax burden by examining, during the phase-in stage of the new tax and phase-out stage of existing taxes, various options with regard to tax policy variables, including tax rates, assessment ratios and exemption policies;
- Helped to organize the process of sending out assessment notices;
- Provided legal and regulatory assistance with tax administration procedures; and

In addition to carrying out these activities, the GSU subcontractors carried out the following additional assistance requested by the pilot cities:

- In Tver, developed instructions on calculation and payment of property tax, on the maintenance of fiscal cadastre, and on appeals procedures, and preparing instructions and inquiry materials for the real estate administration department;
- In Novgorod, developed recommendations on setting land rent rates based on market value, formulating regulations for amendments to the legislation during the transition period, developing appeals procedures, and working out mechanism and conditions of land parcel sales.

The GSU workplan also included the development of a monitoring process and enforcement procedures related to the implementation of property taxes in the two pilot cities. However, this work would have required the participation of certain specialists who were not available in a timely manner. A sixth part of the municipal-level workplan that could not be completed was work on public relations and education programs for taxpayers, which did not get underway because of the cutoff of the program.

During its visits in Novgorod, the evaluation team discussed the municipality's experience with the Deputy Mayor. The municipality had developed a capable team for evaluating property value, and this enabled it to build up a property register over the past four years of its preparatory work, thereby strengthening owners' property rights. However, only 40 percent of dwellings in the city were owner-occupied. It was difficult to increase this ratio, because under the federal law the property can be transferred only if the land has been privatized. Privatization of housing in Russia has experienced this

unusual problem: occupants often do not want to accept ownership, even when offered free of charge. There are two principal reasons for this behavior: the consolidated real estate tax would be higher than the existing individual property tax, and tenants would not want (or could not afford) to pay maintenance costs.

The issuance of bills to taxpayers for the new real estate tax had been postponed to 1999, due to management problems preceding GSU's takeover of the project. The new deadline, June 1999, was contingent on the renewal (with amendments) of the special federal law that had allowed the real estate tax experiment to take place. After June 1999, the two cities ran the risk that they could not collect revenue from the three former property taxes, which had previously been billed, while it was too late to collect the real estate tax before the end of 1999. Since the necessary action on the enabling federal law had not occurred by mid-1999, USAID decided to discontinue the project in July. Since then, the State Duma has approved the legislation, although further action by the Federal Council and the President is still required for the legislation to become law, and as of the time of the writing it was still forthcoming.

City of Novgorod officials interviewed by the evaluation team expressed their intent to move ahead with the Real Estate Tax Project, even if no more TA were available. However, city officials (e.g., the Deputy Mayor) would like to see a continuation of the project. They were proud of the progress made and noted that more than ten other cities had visited Novgorod to learn how to initiate their own plans to introduce a real estate tax. The Novgorod municipal government expressed the desire to continue work with GSU/CREA. The Deputy Mayor said that it would be helpful if the federal government as well as the oblast could assign the entire amount of revenues from the real estate tax to the municipal government.

## 6. Overview of Project Performance

The USAID-GSU project provided a considerable quantity of technical assistance and training, most of which was of high quality. Project managers focussed on activities that responded to needs expressed by counterparts. The evidence shows that counterparts valued the GSU work highly.

Although GSU's work succeeded in nudging Russian officials along the path of fiscal reform—or stopped them from taking actions that would have made the situation worse—the short-term impact of the project has been limited; many of the project's benchmarks are yet to be achieved. The most important constraint on impact has been a lack of Russian political will and widespread consensus about reform. A number of other factors, some of which could be influenced by the contractor and others not, also contributed to the lack of more significant progress. The final assessment of the project's impact, however, will not be known for some years, since many of GSU's reports and recommendations are still being discussed and the people that it helped to train are actively involved in fiscal policy management.

The following paragraphs provide the evaluators' summary assessment of selected aspects of project performance and impact across the six technical areas.

- a) **Technical personnel.** GSU generally provided talented and capable technical staff, although some of its expatriate tax and economic experts had limited experience in, or knowledge of, Russia. Before they could be effective, there was an initial learning period which included the development of relationships with counterparts. However, GSU was quite successful in recruiting well-trained and –motivated Russian experts, generally quite young, who enthusiastically supplied badly needed liaison with Russian counterparts. In two key cases—Natalya Kalinina and Galina Kourliandskaia—the Russian staff was seasoned in Russian fiscal reform work and well-connected with Russian networks.
- b) **Technical quality and approach.** The evaluation team finds that the selection of activities and the quality of work were up to international standards. With respect to its approach, TA providers generally view it as appropriate to be responsive to host country demand, and the GSU team normally followed this principle. In a few instances, however, the evaluation team questions whether the approach of the project was best fitted to Russia's situation. For example, the real estate tax project, whose approach was established prior to 1998 and to GSU's involvement, aimed at introducing a sophisticated real estate tax system that imitated the U.S. model rather than designing a simpler model better fitted to the less developed state of the Russian real estate market. (This criticism is one that GSU itself has made to the evaluation team.) In another case, the project's work in the regions, while useful in building capacity in regional administrations and sharpening local thinking about fiscal management, would have contributed more to improving the overall rationality of the tax system if accompanied by badly needed reforms in the intra- and interregional structures of taxation. Project assistance in these cases shows that programming in

response to counterpart demand does not necessarily produce the same results as programming to achieve a specific set of objectives; of course, there is no way to know with certainty whether a more aggressive effort to undertake strategic and organizational changes for which there was little apparent demand would have yielded significant positive benefits.

- c) **GSU project management.** The project was managed by skilled technical experts with limited experience in managing large overseas projects. Management personnel faced many difficult problems (see, for example, items d, e, and f below), generally dealing with them quite well. Coordination with Barents and U.S. Treasury advisors in two fields—tax policy and economic analysis—seems to have been quite successful; and a number of pathbreaking initiatives were mounted, for instance, in work with the Duma on tax policy and with selected regional governments. A specific criticism that the evaluation team heard from USAID and other TA providers was that GSU was slow to get its team in the field. In this regard, the USAID/GSU contract indicates that GSU won the project in mid-December 1997, was expected to start in the field in mid-January 1998, and had six months (until mid-June) to field its full team. GSU did have staff in the field in January 1998, and it provided staff in all technical areas over the following six months. However, there were some issues of acceptability of staff, filling assignments with temporary personnel and USAID approval that were not fully resolved until after the mid-June target.<sup>24</sup> The evaluation team feels that GSU substantially met those start-up targets.
- d) **Length of project.** In assessing the contractor's performance, one obviously must take into account the time and resources available. With respect to time, although USAID presumably had legitimate reason(s) for setting this project up for only two years, the evaluation team believes that the levels of activities, outputs benchmarks were very ambitious for such a short time frame. Expending as much as \$10 million effectively within two years of project signing is an enormous management challenge. This is particularly true in an area like fiscal policy reform, in which progress requires difficult political decisions by the host country government. A two-year project, particularly with a contractor new to the setting and to large-scale project management, is probably too short to expect major achievements.
- e) **Budget changes.** The one-third reduction in the planned budget for the first two years, occurring mid-way through an already short contract period, reduced the level and scope of what the project could reasonably be expected to achieve. The reduction in the project budget and changes in its scope of work contributed to an already difficult environment for the project.

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<sup>24</sup> In the area of economic analysis, for example, GSU initially fielded a candidate in March 1998 whose experience was subsequently determined to be too narrow for this position. GSU provided a second candidate who arrived on May 31, 1998 to work for a two-month period. That candidate, who proved to be fully acceptable, agreed to stay on and, after brief trips to the U.S. to make arrangements, became the project's team leader for economic analysis. In this case, the expert was in the field working before the six-month deadline, but may not have been confirmed as team leader until after that date.

- f) **Coordination between TA providers and changing scope of work.** As noted in III. 3 above, the first year of the project was marked by the partial failure of the various U.S. TA providers working on tax reform to coordinate their efforts in an effective and harmonious fashion. Much of the responsibility for this set of problems lay outside of GSU, although it and other TA providers seem to have had some personnel who either failed to see the need to resolve these problems or lacked adequate interpersonal skills and judgment. USAID itself contributed to the problem initially by not adequately clarifying roles before GSU came on the scene and by then trying to create what the evaluation team views as an unworkable organization structure. To its credit, after the problem became known USAID took aggressive (and eventually effective) action in June and October of 1998 to resolve it. However, the resolution of this issue involved a major change in GSU's scope of work—phasing out its tax administration work—that involved changes in plans and staff.
- g) **Russian readiness for reform.** A significant constraint on the project's impact, as explained in the background section and at the beginning of Section III, was the inability of the Federation government to carry out needed reform legislation and to implement effectively on a nationwide basis those reform initiatives that had been undertaken. In this regard, and with the benefit of hindsight, the evaluation team believes that the project might have devoted more attention to the areas of consensus-building—although in this regard an important and laudable start was made with the State Duma. Two additional areas might have involved the staff of the Federation Council and representatives of the Russian private sector in the reform process.<sup>25</sup>
- h) **Changes in government leadership.** The normal problems of establishing rapport with counterparts were compounded by discontinuities in leadership in the Ministries of Finance and the State Tax Service (which was changed to the Ministry of Taxation during 1998). These discontinuities reflected the fact that there have been five Prime Ministers, with shifting sets of subordinates, since the beginning of 1998, and this has led to substantial disruptions in the reform process.
- i) **Responsiveness to Russian needs.** One of the principal tenets of the GSU proposal was the idea that GSU advisors would work closely together with Russian counterparts and also with Russians employed by GSU, and would work only on issues the Russian officials themselves identified as needs. To a considerable degree, they succeeded in doing this, and where they did so, the response from counterparts was, predictably, especially positive. For example, Russian counterparts were particularly pleased with GSU's analyses and estimates of tax policy proposals and its work on expenditure needs and transfer mechanisms, both between the Federal

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<sup>25</sup> The evaluation team recognizes that GSU did seek the views of AmCham and some foreign private firms, and that there could be problems for USAID contractors collaborating with private firms. Despite these points, however, the great need for the Russian private sector to get involved in the tax reform process suggests the desirability of coordination of TA with private efforts to achieve tax reform.

government and regions and within those regions, where GSU worked.<sup>26</sup> In general, members of the GSU team—both expatriate and Russian—appear, in most of the project areas, to have established good rapport, trust, and effective working relationships with their Russian counterparts.<sup>27</sup>

- j) **Transfer of skills.** The GSU team succeeded in transferring knowledge, in the form of models and other analytical or forecasting frameworks, to staff members of the Ministries of Finance and Taxation, the Budget Committee of the State Duma, the regional administrations of the six oblasts where GSU worked, and the municipal administrations of Novgorod and Tver. In addition, and perhaps more importantly, they mobilized and provided further training to a team of Russian specialists, who will be available for further work in the fiscal field once the project has ended. In both these respects, the GSU project has added to Russian capacity to sustain the fiscal reform effort over the coming years.

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<sup>26</sup> Another piece of USAID-funded TA that received strong praise was the work of the U.S. Treasury during 1999 on preparing the ground for a World Bank project to modernize the State Tax Service.

<sup>27</sup> One USAID comment on the draft report suggested that the evaluation team “should consider the appropriate distance of GSU to maintain objective and apolitical relationships with counterparts.” However, the team was not initially asked to examine this issue, nor did it happen upon any evidence of GSU having inappropriate relationships with Russian counterparts in this respect.

#### **IV. Technical Assistance Originating in Other Programs**

During the period under consideration (1998-99) there were a number of other programs, besides the GSU program, providing TA to the Russian government in the fiscal area. Among these, the most important in terms of resources provided have been the World Bank (Bank), International Monetary Fund (IMF), and the European Union's program of Technical Assistance to CIS Countries (TACIS). In addition, USAID funding of U.S. Treasury activities and Russian think tanks also led to provision of such TA. These non-GSU sources of assistance are summarized below, grouped by the same categories as those defined in the GSU program and around which the discussion in Section III is organized. Since there was no assistance known to have been given in the property tax area, this category is not listed below.<sup>28</sup>

This section will be largely descriptive, as assessing the quality and impact of these programs would have required far more time and resources than were available to the evaluation team. Aside from describing the programs briefly, the evaluators comment on the effectiveness of programs and the coordination among donors (or lack thereof) only where authoritative views were readily available.

##### **1. Tax Policy**

Several other donor agencies besides USAID/GSU were involved with assistance to the MinFin and MinTax on tax policy agencies. Among these, notable were the following:

- The Swedish Ministry of Finance provided advice on taxation of offshore and internet transactions.
- The German Ministry of Finance and German Federal Tax Service provided experts on a short-term, ad hoc basis.
- "Taxis Bistro" (i.e., short-term assistance under the TACIS program of the European Union) helped in late 1997 to prepare a simplified version of the Tax Code, comparing it with existing provisions, for the use of Duma members and others interested in tax reform.
- The Know-How Fund of the United Kingdom has provided advice on the taxation of financial instruments, and studied the impact of increasing the relatively low levels of taxation on banking activity. It also prepared (in conjunction with the World Bank) economic and financial models of the impact of various tax regimes and tax rates on the level of economic activity and on incentives to investment in the oil sector, and carried out a comparative study of alcohol taxation, to provide alternative models for Russia.

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<sup>28</sup> It should be noted that an invaluable source for this section was the TACIS *Report on Taxation Reform in the Russian Federation*, which was prepared by Thornton Springer Chartered Accountants in 1998.

- The Japanese government, partly in cooperation with the OECD, has offered courses at five centers on general principles of taxation, and on Japanese taxes (for Russian enterprises doing business in Japan).

In addition to these sources of assistance, two other sources indirectly funded by USAID should also be mentioned. First, U.S. Treasury representatives working first in conjunction with the Barents program (continuing until September 1998) and after early 1999 on their own—but still funded by USAID—contributed advice on tax policy issues to the Ministries of Tax and Finance. Second, the IET (chaired by Yegor Gaidar) received a USAID grant beginning in late 1998, and part of that grant was used to finance tax policy studies and to provide advice to the government. IET utilized the services of several U.S. advisors, including Bob Conrad, Joel McDonald, and Michael Alexeev, who had been active under earlier USAID tax reform projects.

TACIS is currently preparing a major program in tax policy. This program, which will dwarf previous EU assistance in this technical area, will make European expertise, experience and documentation available for a wide range of taxes.

Unfortunately, there is little evidence of effective coordination among these various donor activities. This lack of donor coordination exacerbates the division of responsibility for tax policy within the Russian bureaucracy between MinFin and MinTax, further reducing the likelihood that needed tax reform will be enacted and implemented. The fact that the forthcoming TACIS project is starting by setting up an interagency coordinating committee in the president's office is encouraging. This initiative also needs to encompass the donors themselves, and that coordination among donors needs to go beyond occasional meetings to exchange information.

## **2. Economic Analysis**

The one non-U.S. program in the economic analysis of fiscal issues is the TACIS program, called RECEP—Russian-European Centre for Economic Policy. This project produces reports on economic trends, as well as papers on various aspects of economic policy, and sponsors workshops that bring together both expatriate and Russian economists. The Centre is staffed by young expatriate (i.e., Western European) and Russian economists, and results, *inter alia*, in useful experience and contacts for the latter. In principle, RECEP studies may result in policy guidance to the government, although the direct policy component of this project is largely a thing of the past.

Another TACIS project, “Support to Economic Federalism and Public Economic Law,” involves two Dutch scholars and Russian colleagues working with the Ministry of Economy to study ways in which the Russian government intervenes in the economy, especially with regard to different types of regulation. While not directly involved with fiscal problems, the project may reveal extra-budgetary activities of regional and local governments.

### **3. Tax Administration**

The U.S. Treasury, in collaboration with the IMF and World Bank, has provided TA to assist in the long-term development of a modernized information system for MinTax. As explained earlier, this TA has been provided without GSU involvement since April of 1999. Following GSU's withdrawal from the project, three Treasury-sponsored experts stayed behind, of whom only one (Eric Stonecipher) remained as of end-1999. He seems to have won the confidence of Minister Potchinok and Mishustin and is apparently rendering useful services in the area of tax enforcement. Present MinTax emphasis is on large taxpayers in the ten economically most important regions, from which about 85 percent of the tax is collected. As of the time of this report's writing, Minister Potchinok is about to visit Washington to discuss with the World Bank, IMF, and U.S. Treasury plans for a major Bank loan to Russia for modernization of the tax administration system.

Over the past two years, the IMF provided a senior-level resident tax administration advisor, who assisted the top leadership of MinTax. In collaboration with the World Bank, the Fund intends to continue supporting the preparatory work (in collaboration with the U.S. Treasury) for the Bank tax administration modernization program (TAMP).

Several donors provided training on tax administration for STS (later MinTax) staff. TA providers included TACIS/EU, the OECD, and the Danish government, operating through the Moscow International Tax Training Centre. In addition, TACIS/EU has also provided certain tax inspectorates with help in computerizing tax collections, and the French Ministry of Finance has also contributed to this effort. The U.S. Trade Development Agency has also provided assistance to the STS with its information systems. Finally, other bilateral aid—for instance, from the German KfW and the Swedish Ministry of Finance—has been offered on different aspects of tax collection, for example, VAT collection procedures, and systems and rules for taxpayer appeals. These efforts have been coordinated neither with each other nor with those of U.S. TA providers, thereby contributing to different computer systems being used by tax inspectorates in different regions.

Nevertheless, there has been close and collegial coordination among the IMF, World Bank, and U.S. Treasury—now the most important TA providers in the tax administration field. This coordination has been especially impressive in comparison with the lack of coordination in most other areas of fiscal TA. It may also be noted that persistent, long-term contacts between the Russian government and the two Bretton Woods institutions appears to have contributed positively to the increased determination of the Ministry of Taxation, and now higher levels of the Federation government, to develop a more effective and modern tax administration system.

#### **4. Intergovernmental Fiscal Relations**

Compared to the size of the country and the importance of its problems in this area, TA on intergovernmental fiscal relations has been modest. Non-U.S. technical assistance has included:

- The German Technical Assistance Corporation (GTZ) has been carrying out work as a contractor to the World Bank, assisting selected regions with budgetary formulation and monitoring. The GTZ will begin in 2000 to provide advice to MinFin on the formula for federal government transfers to the regions.
- The earlier-mentioned TACIS research project on “Support to Economic Federalism” touches on legal foundations of intergovernmental relations, including budgetary support of enterprises.

Because the World Bank has on its own initiative kept in close touch with the GSU project and has also employed the GTZ, there has effectively been some degree of coordination of efforts in this area.

The World Bank's new project on intergovernmental fiscal relations is utilizing GSU work, in particular the paper by Boex and Martinez referred to earlier, as a basis for planning its activities. The Bank's program will finance programs similar to those being pursued by GSU in six regions (other than those in which GSU is working); these regions are expected to be Belgorod, Vologda, Samara, and Chelyabinsk oblasts, the Republic of Chuvashia, and Khabarovskiy Kray. This project was to be presented to the Bank's Executive Board in late 1999 or early 2000; work is expected to begin in 2000.

#### **5. Other Fiscal TA**

The International Monetary Fund and World Bank have for several years been helping the Federal Ministry of Finance to build a nationwide Treasury system for the control and disbursement of expenditures. This has been an uphill struggle, given the reluctance of certain government departments—notably the defense establishment—to subject itself to budgetary discipline, and of the regions to permit greater centralized control over those expenditures that are budgeted by Federal ministries but carried out on the regional level. Nevertheless, progress has been significant. The Fund has provided a resident budget advisor to the Deputy Minister of Finance in charge of the Treasury, and has also been sending short-term technical missions several times a year. The U.S. Treasury has, on occasion, also offered advice and assistance in this area. Meanwhile, the World Bank is considering a major loan that would permit nationwide computerization of Treasury operations, initiating reform at the Federal level (including the Chamber of Audit) and eventually extending it to the regions. It should be mentioned that in this area there has been close and smooth collaboration between the Bank and the Fund.

The general impression of the evaluation team is that the work of the Bank and Fund in this area has been successful in steadily pushing the Federation government toward

greater transparency in its budgetary implementation. In this respect, the long-term advisor from the IMF, in daily contact with the top officials in this area, seems to have been especially effective. The World Bank's work with the Russian Treasury has been largely in preparation for a major loan, whose long-term impact may prove even more important. There are still major obstacles ahead, however, especially with regard to bringing the military establishment and the regional governments within the ambit of federal Treasury operations.

## **V. Findings: What Has Worked, What Has Not Worked, and Why**

This section provides the evaluation team's conclusions on what works and what does not in providing TA on Russian fiscal reform.

**1) Meeting Russian needs.** Russian counterparts emphasized the need for advisors to be tuned in to the Russian situation, sensitive to the political constraints, and capable of coming up with feasible, usable, concrete proposals that meet specific Russian needs in a timely fashion. Likewise, it is important to choose analytical techniques that are relevant to Russian experience, data availability, and structural features. In response to these preferences, the USAID mission and the GSU team emphasized a demand-driven approach in this project.

Despite the indisputable merits of demand-driven technical assistance and notwithstanding the increased ability of Russian policy makers to decide on their own general reform blueprints, there is a danger that purely demand-driven TA simply meets the parochial needs of specific counterpart agencies (or those whose tenure as leaders of those agencies may be short-lived) and not the needs of the system as a whole. This danger is particularly prevalent when there is a lack of coordination and consensus among the key Russian institutions. It is, of course, true that demand-driven TA does create opportunities for TA providers to change the views of beneficiaries, and no one could argue that purely supply-driven TA is either feasible or desirable. For more on this point, see g) below.

**2) Characteristics of TA providers.** The ideal expatriate expert is a Russian speaker and resident in Russia, with deep knowledge of and past experience with the country, but also recognized professional competence and broad international experience. Clearly, this combination of characteristics is hard to find. As time goes on, however, there is a growing list of expatriate experts with knowledge of Russia, and by agreeing to extended stays in Russia and teaming with the growing number of (generally younger) relevantly trained, English-speaking Russian professionals, TA can be effectively delivered. However, Russian counterparts interviewed for this report were firm and unanimous in voicing their view that they were no longer interested in “flying professors,” unless their visits were connected with more extended, sustained TA efforts in the field.

**3) Continuity.** Although there are clearly legitimate reasons (e.g., contracting rules, the need to rotate personnel) for changing technical assistance providers, this evaluation revealed considerable evidence that such changes can result in significant set-backs in the achievement of project goals. Judging from the comments of counterparts, the USAID’s assistance program in fiscal reform suffered from this problem. Russian counterparts told the evaluation team that every change in advisors—unless they have strong previous Russian experience—requires a time- and resource-consuming period of education before they can deliver useful assistance. They also pointed out the importance of building up personal relationships as a foundation for fruitful cooperation, hence the “back to square

one” situation that counterparts’ sense when contractors changed. A positive example of continuity is provided by the long-standing relationship between the Ministry of Taxation with the U.S. Treasury and the Bretton Woods institutions, a relationship that seems to be heading toward tangible results as embodied in the forthcoming tax modernization program.

**4) Building Russian capacity.** In part for reasons just mentioned, but especially for the obvious reason that Russia is a vast country with enormous tasks before it, there is a large need to build Russian capacity in such fields as economics, accounting, and Western-type law, in order to sustain the reform momentum for the many years that will still be required before a satisfactory fiscal system is achieved.

A major impediment to moving ahead on reform is the difficulty faced by governments, with their extremely low pay, to keep well-qualified personnel. Consequently, the GSU team ended up with small numbers of technical staff in ministries with whom to collaborate and to whom to transfer skills; those younger, better educated, and more competent of these staff that have remained seem likely to leave government service after a few more years. Nevertheless, GSU and other donor efforts have played a useful role by hiring and training young Russian professionals—who were needed to overcome language problems of expatriate experts—and thereby increasing their experience, skills, and future value to the fiscal reform effort. It may, however, be useful in future programs to target explicitly such capacity building within the government, as well as in think-tank institutions. (How best to do so is a difficult question discussed in Section VI.)

**5) Building consensus.** As pointed out in Section II of this Report, consensus building in the area of tax reform is a still largely unachieved task in Russia. One of the major accomplishments of the GSU project, assisted by a fortunate change of attitude in the Ministry of Finance, was to extend significant TA to the Budget Committee of the State Duma, and to do so in ways that led to further demand for such assistance. Extending such TA to the Federation Council is a step yet to be taken, and this would have to be related to efforts to involve regional governments in a dialogue on the shape of inter-governmental fiscal relations and national tax policy—an ambitious task, indeed. (Section VI includes suggestions on ways to encourage a broader dialogue.)

Another dimension of consensus-building lies in the dissemination of information. Russian translations of GSU publications—especially on IGFR—have been a helpful step, as have been project workshops on intraregional budgetary relations, to which some nonparticipating regions were also invited. Here, too, it is possible to imagine even more active dissemination efforts, but this would have required greater project resources. In this connection, favorable ratings were given to the TACIS Bistro for producing a simplified version of the proposed Tax Code to improve the understanding of Duma members and other officials having access to this document. In order to promote a truly national dialogue on these issues, such documentation should be disseminated more widely—not only to official agencies but also to the business and academic communities.

**6) Coordination of donor efforts.** Donor coordination is frequently an issue when there are several donors and/or contractors working on the same or related topics. In the Russian fiscal reform efforts, despite some instances where effective coordination was carried out,<sup>29</sup> coordination has been inadequate. The significance of donor coordination is several-fold: (a) it avoids wasteful duplication of TA resources. (b) It can help the government itself coordinate its own policies, especially where the government is divided and subject to the kinds of interagency rivalries that have been endemic within the Russian Federal government. (c) It avoids different TA teams working at cross-purposes. (d) It helps build productive relationships with counterparts—when more than one TA provider is working with the same counterpart, the counterpart does not know with whom it should be working.<sup>30</sup>

**7) Impact: has the Russian tax system improved since 1997?** In the evaluators' view, the efforts of the Russians and foreign experts have to date produced only modest improvements in the fiscal system. The key constraint is in the limited ability of the Russian Government to adopt and implement reform. Essentially, Russians will need to address the fundamental political issues (see Section II) that impede movement to a modern fiscal system.

In this context, perhaps the most that can reasonably be expected is that donor assistance will help gradually to increase the understanding (especially on the part of officials and politicians) of the need for reform, to generate the right types of requests for assistance, and to move the system in the right direction. Clearly, some of this has occurred in Russia. For example, donor assistance has strengthened the foundations of further reform through capacity-building and some incremental improvements in legislation.

Nevertheless, the evaluators believe that external assistance has not always been as effective as it might be. As mentioned earlier, a major problem of demand-driven technical assistance is that it meets narrow and mostly technical requests of Russian counterparts, without necessarily assisting the Russian government as a whole to move forward with a comprehensive vision of reform of the tax system. It is particularly important not to lose sight of the overall picture, in view of the tendency for continuing interdepartmental conflicts and lack of coordination among the different agencies of the Federal government, between the executive and legislative branches at the Federal level, and between the Federal and regional governments. For example, giving advice to regions on how to raise incentives for municipalities to improve their tax transfers to the regions could be regarded as a waste of resources if set within an overall national tax system that runs counter to the goals of transparency, accountability, and consistent

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<sup>29</sup> As noted in previous sections, coordination was often quite good between GSU with Barents and the U.S. Treasury on tax policy, the IMF and World Bank with the U.S. Treasury on tax administration, the IMF and World Bank on MinFin Treasury reform, GSU and the IMF on tax revenue estimates, and GSU with the World Bank on intergovernmental relations. Occasional linking of GSU and TACIS efforts has also been reported to the evaluation team.

<sup>30</sup> Please see Section VI.1.j for some suggestions for bringing about better coordination, both among U.S. TA providers, and among all “Western” donors.

expenditure and revenue assignments. Similarly, while modernizing the tax collection system for the Ministry of Taxation is a worthwhile goal, its contribution to creating an overall more coherent system is greatly reduced if the State Tax Police and the four social funds are simultaneously developing separate systems for monitoring and collection. Better tax collection does not necessarily “support market-oriented growth” if the tax structure continues to impose excessive burdens on enterprises and to create large incentives to maintain an informal economy. Certainly, without fundamental reforms in the tax structure, it would be hard to achieve the aim of substantially reducing the cost of taxpayer compliance, which was one of the explicit aims of the project. Finally, the evaluation team notes that technical assistance has been focused largely on the tax side and paid relatively little attention to the expenditure side. Improving tax policy and administration is likely to fail in the long run unless there is transparency and efficiency in the expenditure of fiscal revenues.

## VI. Recommendations

These conclusions are grouped in two parts: first, general considerations to take into account and, second, specific recommendations with regard to topics of future TA in the fiscal area.

### 1. Building Effective Technical Assistance Programs

- a) **Continuing need for TA.** Despite high levels of education and general technical know-how, high-rank Russian officials—at the Federal level, and even more at the regional and local levels—still have an acute need for TA in the fiscal area. This need stems partly from their own lack of experience with modern, market-oriented fiscal systems—which leads them to tend to fall back on Soviet-type bureaucratic mechanisms—and partly from their lack of financial resources—which makes it difficult for them to hire well-trained and competent Russians at the technical level.
- b) **A window of opportunity?** With the election of a more centrist Duma, the resignation of President Yeltsin, and the likely electoral confirmation of Acting President Putin in March, the year 2000 may see the opening of a major window of opportunity for fiscal reform. A recent published statement of Unity Party chairman Sergei Shoigu pledges (*inter alia*) “to fight to overhaul our cumbersome tax code in ways that lower rates, combat illegal evasion and eliminate loopholes that are unfair to ordinary citizens” (Washington Post Op-Ed page, December 26, 1999), and he suggests that both the government and voters “want constructive relations between the Duma and the [Yeltsin] government.” The fact that President Putin would be closely tied to a major bloc in the Duma represents an important forward step in the development of Russian democracy; more specifically for tax reform, it makes it far more likely that a coherent package of new tax legislation will finally be passed. The one remaining problem is the passage of such legislation by the Federation Council, and its effective implementation at the regional and local levels.
- c) **Russian demand for targeted and practical advice.** Notwithstanding the continuing needs for TA, Russian officials, especially at the Federal level, are increasingly skeptical and selective with regard to TA, and will increasingly demand that it be carefully targeted and fit their practical needs. However, while the emphasis in TA should be on the delivery of techniques rather than “blueprints” that illustrate basic principles, the latter should not be entirely forgotten, in view of the fundamental weaknesses of the Russian fiscal system discussed in Section II.
- d) **Capacity building.** In the face of the Russian Government’s continued low level of pay and the resulting difficulty it experiences in retaining competent technical personnel, the evaluation team applauds USAID’s and other donors’ efforts to explore options for developing capacities outside the government. Particularly noteworthy in this regard is USAID’s effort to strengthen private sector think-tanks, which can then be consulted by the government. It should be noted, however, that not all

counterparts interviewed agreed with this idea, and donors need also to continue seeking ways to strengthen capacities within the government. This latter effort is likely to require serious improvements in salary or other incentives to keep technical talent from moving to the private sector.

- e) **Consensus-building.** Consensus-building is an essential part of any policy reform effort. While those leading such effort may need to be host country nationals, consensus-building is an appropriate activity for technical assistance programs. Technical assistance on fiscal reform must address the need for support in both the public and private sectors. GSU's successful work with the federal Duma is just one example of the useful role technical assistance providers can play. Future consensus-building activities might incorporate ALL of the key actors. In this case, the workshop suggested in item j) below might be a vehicle for exchanging ideas about this. Consensus-building will need to include the Federation Council and the regional governments it represents. Without their support of national legislation, and regional and local implementation of such legislation, reform can only be partially effective. Better coordination of the executive and judicial branches of government would also be desirable.
- f) **Dissemination of information.** Disseminating important analyses and reports can be a major means of consensus-building. Future projects should be designed so as to assure that reports, results ("best practices") and experience (international, national, regional) are vigorously disseminated throughout the Federation, including to the academic community, the private sector, and the Federal government itself. Dissemination efforts should, in fact, target the general public, in order to increase awareness of voters of tax policy issues, and thus to expand political support for tax reform. Despite the added time and expense, it may well be worthwhile for TA providers routinely to prepare two versions of key studies and reports: one for government technical staff and decision-makers and another for the press and the general public.
- g) **TA for the regions.** With the large shift of expenditure assignments from the center to the regions that took place throughout the 1990s, Russian public sector problems are increasingly concentrated at the regional level. Regions have broad discretion *de facto*, and to some extent *de jure*, in structuring their fiscal systems. At the same time, the capacity of regional governments to implement fiscal reform is severely constrained by lack of qualified personnel. Moreover, due to low mobility of labor, the continuing investment crisis, and the weakness of Russian democratic institutions, the mechanisms of interregional dissemination and competitive selection of best practices by subnational units are not fully functional in Russia. These facts imply that there is a need for proactive interregional dissemination of policies successfully tested and implemented in pilot regions, and international TA providers need to support and provide initiative for such dissemination.
- h) **Characteristics of TA providers.** In the delivery of TA, it is especially desirable to have providers who know Russian, are full-time residents during the project, and have

acquired prior knowledge of Russian circumstances. They should, of course, be recognized experts with international knowledge and experience. Admittedly, a rather small number of experts can claim all these characteristics, but in any event the full-time residency and prior knowledge about Russia are important, and must be coupled with close collaboration with Russian co-workers. Short-term international experts can be useful, but only if their efforts are closely coordinated with a team in the field.

- i) **Continuity of TA provision.** Continuity is considered extremely important by the Russian counterparts themselves. Lack of TA continuity in the past has tended to exacerbate the lack of continuity within the Russian government (although recent and prospective political developments promise greater continuity in the future). Senior officials prefer sticking with the same group of providers whenever possible, rather than “educating” new advisors in the complexities of the Russian environment. This suggests that, to the extent that donor procurement rules allow and appropriate personnel can be recruited, it would be advisable to provide TA through experts who will remain involved in Russia’s fiscal reform effort for four-five years or longer,
- j) **Donor coordination.** Donor coordination refers to efforts to harmonize USAID efforts with those of other donors and to ensure that its own set of TA providers essentially work as a team. With regard to the former, the evaluation recommends that any new USAID projects in the fiscal area be designed to complement the large new projects from other donors that are looming on the scene (e.g., World Bank projects in tax modernization and Treasury strengthening, the TACIS project on tax policy). There will need to be more effective attempts than hitherto at donor coordination, as well as communication with the private sector’s (AmCham, etc.) lobbying efforts. One idea to promote such coordination is an annual or semi-annual workshop with high-level (but also “technical-level”) representation from all interested parties (donors, government [both Federal and regional], private sector [both domestic and foreign]).

With respect to the coordination of fiscal TA among U.S. donor agencies and their various contractors, USAID has greater control and responsibility, although within limits imposed by the State Department, the U.S. Treasury and others. Experience suggests:

- It would be best to avoid having more than one agency provide fiscal TA in any specific area (e.g., treasury development or tax policy);
- If more than one agency intends to undertake fiscal TA, specific assignments should be explicitly clarified by interagency discussion and agreement *before* commencing field activities;
- Once these assignments have been clarified, arrangements should be made for regular meetings and exchanges of information.

- Clear assignment of responsibilities and regular exchange of information should make it possible for USAID/Russia to carry out its normal and necessary monitoring activities without trying to directly manage relationships between contractors.

USAID may wish to experiment with making TA providers part of a strategic objective team and jointly responsible for the achievement of strategic objectives. Such an arrangement would USAID and its contractors discuss the overall direction of fiscal reform in Russia, and appropriate adjustments in project activities, on an ongoing basis. In this regard, USAID might also examine coordination of its fiscal projects with related TA—e.g., with its program for SMEs, for which tax problems are an extremely important obstacle to entering and staying in business.

Finally, the pro-active dissemination of reports and best practice cases throughout Russia, as recommended above, would have the additional benefit of providing ample exchange of information among donors—of course, on the understanding that other donors besides USAID would participate in such dissemination.

**k) The need for fundamental reform.** In line with Section V.g above, future TA should be carried out with the realization that while gradual reforms should continue to be sought, the overall fiscal system will not work properly, and Russia will not become a prosperous country with a properly run, market-oriented state, until certain fundamental reforms occur. It is with these fundamental reforms in mind that the incremental, near-term reforms—which are the appropriate province of donor-supported TA—should be designed. Important fundamental reforms include the following:

- *Eventually eliminating shared taxes.* In the view of the evaluation team, it would be preferable in the Russian context to assign each type of tax to one level of government or the other. It may also be best to have separate tax collection systems for each level of government: while examples of joint tax collection can be found among successful federations (Canada, Germany separate systems in Russia might be a more effective means of suppressing incentives for lower levels of government to prevent passing tax revenues upward to the higher levels. Of course, as discussed earlier, there are both political and capacity problems that make such a system a long-term goal to be gradually achieved, rather than a feasible short-term objective.<sup>31</sup>

- *Restructuring the Federal tax collection system(s).* Separate tax collection systems for each of the four social funds, plus for customs, in addition to the STS of the Ministry of Taxation, with a separate monitoring bureaucracy of the State Tax Police, is extremely inefficient and wasteful of resources. This system also creates confusion, higher administrative costs and potential harassment for taxpayers, and misses an important opportunity to create an efficient monitoring

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<sup>31</sup> For further discussion of this point, see subsection II.3.2). As noted in that discussion, there is disagreement among experts on how much emphasis to give to this point.

system in which taxpayers have incentives to pay (e.g., in the U.S., no tax payment, no state pension). In addition, computerization of the most important of these systems, the STS, must be accompanied by a restructuring of its organization—for instance, by replacing the taxpayer-based structure with a function-based one, in order to reduce the scope for tax evasion and corruption.

- *Reducing the burden of taxation on enterprises.* Reducing tax rates, too, will be difficult to accomplish—although now proclaimed by most Russian politicians as a goal—without reform in the two above-mentioned areas. There needs to be an integrated approach—not simply separate and unrelated TA programs at the center and in the regions.

- *Increasing the scope and transparency of official budgets at all levels of government.* Russia must reduce extra-budgetary operations, as well as budgetary operations (like those of the military) that are not included in the Treasury mechanism of controlling disbursements. This point needs emphasis because these operations are thought to be large (though admittedly hard to measure) and because they impinge not only on the efficiency with which tax revenues are used—and thus indirectly on the level of revenues that are targeted—but also on taxpayer morality and compliance.

## 2. Priority Technical Areas

- a) Tax policy.** Russian counterparts would find it extremely useful to continue being provided with ad hoc analyses and forecasts of specific policy proposals. However, the evaluation team suggests that a TA provider insist (with donor support) counterparts a list of tax policy priorities on which there is broad consensus—e.g., harmonization of VAT and sales tax, lowering the tax burden on business, broadening deductions for the enterprise profits tax, eliminating turnover taxes, reducing payroll taxes. The approach to tax policy TA needs to be *comprehensive*: for instance, payments to the social funds, the single greatest *de facto* tax payment, have not even been covered by donor fiscal reform programs, although there are Russian officials who have been interested in progress on this issue. Comprehensive reform is possible only with the active participation of both the government *and* the national legislature (including *both* the Duma *and* the Federation Council). In the case of the Federation Council, this means establishing close working relationships with the staff of the Council (since its members are in Moscow only one or two days a month) and finding ways to involve regional governments in dialogue about the tax system.
- b) Economic analysis.** The evaluation team questions the usefulness of a separate economic analysis component in any further tax reform project. But if it is to be a part of a future project, then its focus should be rethought. So far, economic analysis has been heavily concentrated on implications of various tax reform measures for revenue collection—not surprising, since the main client of this analysis was MinFin. Much less attention has been paid to assessing the economic efficiency of the tax system, i.e., the economic distortions caused by the tax structure, tax incidence, and

similar issues that lie at the core of Russia's overall economic predicament. Granted, these questions are considerably more difficult than partial-equilibrium tax revenue estimates. The usual problems of general-equilibrium analysis are further compounded in Russia by the profound changes that the economic structure is undergoing: the time series data required for testing economic models are either too short or simply nonexistent. These technical problems, however, should not preclude broader economic analysis of the Russian tax system.

- c) **Tax administration.** This is clearly an area where the government is determined to move decisively, specifically with regard to modernizing and centralizing its information system. The World Bank will loan the money, but related expertise—especially in the area of organizational restructuring and staff redeployment and development—will have to be obtained elsewhere. MinTax is likely to be happy to continue its long association with the U.S. Treasury, as well as the IMF, in this field.
- d) **Intergovernmental fiscal relations.** This is a field where some useful work has been done, and much more work is needed. Priorities include moving to a client-based rather than Soviet-type facility-based approach to allocating expenditures. More active dissemination among all Russian regions of lessons learned in this area would be highly worthwhile. However, some activities, such as calculations of tax capacities, and trying to devise incentives for subnational units to ensure better collections by local branches of the national tax service, seemed a not altogether helpful support to the distorted federal system now in place. While continuing to help establish more transparent and accountable procedures in IGFR, TA providers should also be forthright in pressing the idea that the present overly complex system of shared revenues from several different taxes is itself in need of prompt reform. Here, coordination with TACIS and World Bank efforts would be helpful.
- e) **Real estate tax.** Continued work on real estate tax and work on national legislation to make such taxes available nationwide has certainly been desired by recent and prospective counterparts. Further work in this area should include vigorous dissemination efforts, an attempt to develop a simplified real estate tax system suitable for Russian circumstances, and amendment of the Tax Code to make the property tax strictly a municipal (rather than regional) tax. There is also need for developing the Federal legislation required for allowing nationwide development of such a local tax instrument.
- f) **Other areas.** USAID has hitherto been involved in only an indirect sense in TA in the areas of budget formulation and implementation: i.e., to the extent that the U.S. Treasury has given advice to the Russian MinFin in this field. A major World Bank project to support the strengthening of the Russian Treasury is imminent, and the contractors hired by the Bank may well be U.S.-based. Official U.S. government advice in this area may be sought by the Russian authorities, and, if such a request comes, it ought to be met with a positive response.

## **ANNEXES**

- 1. Members of the CARANA Team**
- 2. List of Interviewees**
- 3. References**
- 4. Scope of Work**

### Resumes of Members of the CARANA Team

*Dr. Anthony Lanyi* is Director of Macroeconomics and Economic Policy. He has a B.A. in history from Harvard College and a Ph.D. in economics from the University of California, Berkeley. He served for 26 years in the International Monetary Fund, where he was Chief of the Developing Country Studies Division in the Research Department and Deputy Director of the IMF Institute. His work in the IMF included operational work—primarily in Asia and Latin America—as well as research on external debt and macroeconomic policy issues. Both inside and outside the IMF—including Princeton University and the School of Advanced International Studies, Johns Hopkins University—he has taught courses on macroeconomic policy and international economics for civil servants, legislators, and students at the undergraduate and graduate levels. Since joining IRIS, his projects have included studies of fiscal reform in Russia; modernization of the government in the Dominican Republic; directing refereed studies and publications on economic reform, and organizing seminars, in India; evaluation of small- and medium-enterprise projects in Eastern Europe for the German Agency for Technical Cooperation (GTZ); and organizing a USAID-supported conference in Egypt on “Growth Beyond Stabilization” (in collaboration with the Egyptian Center for Economic Studies and the Harvard Institute for International Development). Recently, he has been prepared a study, together with Young Lee, on the “Governance Aspects of the East Asian Financial Crisis.”

*Dr. Leonid Polishchuk* is an economist with broad experience in research, teaching, policy analysis and technical assistance. His main areas of research include institutional reform and development, federal-provincial relations, political economy of transition and regional economics. Dr. Polishchuk received a M.Sc. in mathematics from Novosibirsk State University and a Ph.D. in economics from the USSR Academy of Sciences, Institute of Economics and Industrial Organization, Novosibirsk. Since 1994 Dr. Polishchuk has been conducting projects aimed at strengthening domestic capacity for high quality economic research and education in Russia. He participated in and/or supervised collaborative studies of policy-relevant issues, such as privatization, fiscal and public sector reform, social programs and poverty reduction, etc., implemented jointly by Russian and US economists. He also worked with newly-established Russian universities and think tanks to introduce modern advanced level economic curricula, standards and tools of economic analysis, management and accounting procedures. His efforts included strengthening links of these universities and policy institutes to the government and private sector, and developing professional networks of experts and policy analysts. Another area of Dr. Polishchuk’s activities is work with senior officials from the federal and regional governments and leading Russian and Western scholars on the reform of intergovernmental finance, interregional economic inequality, regional development, and legal and constitutional foundations of a federal state.

*Dr. Jitendra R. Modi* is a macro and fiscal economist with 35 years of professional experience in various capacities. He received an undergraduate degree with a double major in commerce and law from Trinity College, Dublin, and a Ph.D. in economics from Edinburgh University; he is also a member of the English bar. He has been engaged in a variety of assignments, including seven years in the Ministry of Finance of Tanzania (his home country), two years in a UNDP assignment as fiscal expert in Sri Lanka, and 24 years as economist and statistician in the International Monetary Fund, including two years as Resident Representative in Jamaica. He is now an independent consultant. His broad range of assignments have included: advising executive staff in government, accompanying them to cabinet and legislature meetings; participating in bilateral and multilateral negotiations, seminars, and conferences; writing technical papers and reports; participating in IMF and World Bank missions to over 30 developing countries in the African, Asian, Caribbean, Middle East, and Pacific regions, as well as transition economies, where he analyzed tax and budgetary reform issues, advised country officials, and participated in their training; holding discussions with NGOs and private sector enterprises and conducting research on specific fiscal and trade expansion issues; providing macroeconomic resource person services to workshops on debt relief in Guyana, Tanzania and Uganda; and providing technical assistance to the World Bank on public sector finance issues in Papua New Guinea.

*Gerald Wein*, an economist, has masters degrees in economics from the University of California (Berkeley) and in public administration from Harvard. Mr. Wein's career has been devoted to development work, mostly with USAID. He worked for USAID as an economist and project planning and evaluation specialist in Latin America and Africa and later as the deputy or acting mission director in Nicaragua, Tunisia and Ecuador. After leaving USAID in 1992, Mr. Wein worked for four years at Abt Associates as the director of two large worldwide projects on health sector finance and policy reform. During the past two years, Mr. Wein has worked as an independent consultant on a variety of projects, including the design and management of five project evaluations for the CARANA Corporation.

VIII.

**List of Interviewees**

John Anderson  
Economist, European II Department  
International Monetary Fund  
Moscow, Russia

Peter Arnett  
Partner, Ernst & Young (CIS) Limited, and  
Chair, AmCham Subcommittee on Tax Policy  
Moscow, Russia

Rudiger Ahrend  
Senior Research Fellow and Director of Macroeconomic Research  
Russian-European Centre for Economic Policy (RECEP)  
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Bill Allan  
Senior Economist, Fiscal Affairs Department  
International Monetary Fund  
Washington, DC

Victor P. Antyufeev  
First Deputy Head, Novgorod City Government  
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Roy Bahl  
Professor of Economics and Dean  
Andrew Young School of Policy Studies, Georgia State University  
Atlanta, Georgia

Petr M. Bomarov  
Assistant, Deputy Governor  
Vladimir Oblast Administration  
Vladimir, Russia

Nigel Chalk  
Economist, European II Department  
International Monetary Fund  
Washington, DC

Bob Conrad  
Professor, School of Public Policy  
Duke University  
Durham, NC

John Carihfield  
USAID/Eurasia  
Washington, DC

Jack Diamond  
Deputy Division Chief, Fiscal Affairs Department  
International Monetary Fund  
Washington, DC

Arkady Dvorkovitch  
Head of Economic Expert Group  
Federal Ministry of Finance  
Moscow, Russia

Allan Firestone  
Tax Administration Consultant  
Washington, DC

Andrea M. Fontana  
Second Secretary  
Delegation of the European Commission in Russia, European Union  
Moscow, Russia

Martin Gilman  
IMF Senior Resident Representative  
International Monetary Fund  
Moscow, Russia

Natalia Vladimirovna Golovanova  
Assistant Researcher, Inter-Governmental Fiscal Relations  
Georgia State University  
Moscow, Russia

Francis Greaney  
Fiscal and Macroeconomic Policy Advisor  
Barents Group  
Tysons Corner, Virginia

Elaine Grigsby  
Director, Office of Economic Policy Reform  
USAID/Moscow  
Moscow, Russia

Lawrence M. Hannah  
Principal Economist and Program Team Leader, Russia Regional Fiscal Reform  
World Bank  
Washington, DC

Robert Heer  
Tax Administration Advisor  
Office of Technical Assistance, Department of the Treasury  
Moscow, Russia (since returned to U.S.)

Sharon Hester  
USAID/Eurasia  
Washington, DC

Richard Highfield  
Senior Tax Administration Advisor  
Tax Administration Division, Fiscal Affairs Department  
International Monetary Fund  
Washington, DC

Joe Hook  
International Tax Consultant  
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Alexander I. Ivaneev  
Head, Tax Policy Department  
Federal Ministry of Finance  
Moscow, Russia

Natalya V. Kalinina  
General Director, Center of Real Estate Analysis  
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Vladislav Kantorovich  
Assistant to 1<sup>st</sup> Deputy Minister Ignatiev  
Federal Ministry of Finance  
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Robert Klayman  
Director, Tax Advisory Program  
U.S. Treasury Department  
Budapest, Hungary

Elmar Kleiner  
Department head, Eastern Europe/Central Asia Region  
German Technical Assistance Corporation (GTZ)  
Eschborn, Germany

Galina V. Kurliandskaya  
Chief of Party (since November 1999)  
Georgia State University  
Moscow, Russia

Vyacheslav P. Kuzin  
Deputy Governor, Vladimir Oblast  
Vladimir, Russia

Thomas Larsen  
Economist, European II Department  
International Monetary Fund  
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Alexey Lavrov  
Department Head, Inter-Governmental Fiscal Relations  
Federal Ministry of Finance  
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TACIS project. “Support to Economic Federalism and Public Economic Law”  
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Allister Moon  
Senior Public Sector Management Specialist  
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Alexander G. Morozov  
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Finance Committee, Novgorod Oblast Administration  
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Alexander P. Potchinok  
Minister  
Federal Ministry of Taxation  
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David O. Robinson  
Economist, European II Department  
International Monetary Fund  
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Vladimir Samoylenko  
President, International Tax and Investment Center (ITIC), CIS  
Moscow, Russia

Alexander Shapleigh  
USAID/Eurasia  
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Sergei Shatalov  
Director, Tax Department  
PriceWaterhouseCoopers  
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Financial review report by the Office of Financial Management: Analysis and Implementation Support (FAIS) No. 99-011, dated August 20, 1999.

United States Treasury Mission in the Russian Federation:  
Status Reports on Tax Modernization Project by Eric Stonecipher (Resident), Frank Jenkins (Intermittent) and Lena Pissarchik (TAMP Coordinator), Department of Treasury, Office of Technical Assistance Mission, dated June 1-30, 1999 and July 1-16, 1999.

World Bank, Fiscal Management in Russia, World Bank, Washington, DC, 1996.

## **SCOPE OF WORK**

### **FOR EVALUATION OF THE IMPACT OF TECHNICAL ASSISTANCE ON RUSSIA'S FISCAL REFORM AND IDENTIFICATION OF POSSIBLE FUTURE WORK**

#### **I. FOCUS OF WORK**

The focus of this project is on the impact of technical assistance (TA) on Russia's fiscal reform since 1997. USAID/Russia, TACIS, World Bank, International Monetary Fund, US Treasury and Organization for Economic Cooperation and Development are some of the donor organizations which have contributed to delivering TA toward reforming Russia's fiscal system during the past few years. There have been both clear successes and questionable impact resulting from this varied TA. Therefore, this project seeks to shed light upon the impact of TA as well as fruitful directions for further work with respect to fiscal reform in Russia.

USAID contractor Georgia State University (GSU) has implemented its two-year Fiscal Reform Project since December 1997. It began working in five components of fiscal reform, namely: 1. intergovernmental fiscal relations; 2. tax policy; and 3. economic analysis; 4. property tax; and 5. tax administration. Currently GSU's workplan includes only the first three of these components. The project, as well as the Russia Mission, has received requests for future assistance in these three areas in addition to letters of appreciation for TA delivered.

GSU's Fiscal Reform Project contributes toward achieving a wide variety of USAID/Russia targets supporting the Mission's Strategic Objective 1.4: "Improved Economic Infrastructure to Support Market-Oriented Growth." Project technical assistance is geared toward the creation of a fair and efficient tax system in Russia and is delivered to the Government of Russia at the federal, regional and local levels.

Other donor-sponsored projects in the area of fiscal reform have been ongoing in Russia for the past several years as well. This work will concentrate on assessing the impact of donor delivered TA in fiscal reform in general and the impact of GSU's project in particular. Areas of future work will also be identified as a result of discussions with Russian government counterparts, reviews of various documents and discussions with project managers and donor contractors in Russia.

#### **II. BACKGROUND**

Reforming Russia's fiscal system is often cited as the "number one obstacle to sustained economic growth." The current Russian federal tax system fails to generate tax revenues adequate for levels of desired public expenditures while, at the same time, is perceived as placing an onerous burden on businesses and unnecessarily distorting economic decision-making. It thus constrains the growth of the economy by discouraging investment and promoting undesirable business behavior. Tax administration and enforcement are perceived to be inefficient, inequitable, and corrupt. Intergovernmental fiscal relations, although improving, remain reliant on negotiation and connections rather than on objective, transparent and efficient criteria. Overall, there is a high degree of inefficiency in the system.

To a large extent, the tax concepts, accounting rules and administrative procedures used in the current Russian tax system are inherited from the Soviet period. These remnants of the command economy were primarily designed to control and monitor physical production rather than accurately measure the tax base and facilitate compliance with tax legislation. Inadequate redesign of the tax system and its administrative structure for a market economy has resulted in economic distortions and high administration and compliance costs. Falling tax revenues generate pressure to increase the tax burden on businesses 'visible' to the tax authorities. The excessive tax costs imposed on visible businesses have encouraged a shift of investment to the underground economy and the use of inefficient business strategies (e.g., barter) to conceal taxable incomes from tax authorities.

While Russia has begun the process of codifying its tax legislation, much work remains in the area of tax policy. Many observers predicted that Russia's tax code would be in effect by the end of 1998. At the present time, however, only the general part of the tax code is in effect; the specific sections of the tax codes face a long road ahead in the coming months and possibly years. Adoption of more fair and efficient tax legislation remains a necessary condition for increasing investment and therefore, for economic growth. It is clear that these separate components of fiscal reform are interrelated and important ingredients in improving Russia's economic infrastructure.

Many donor organizations have delivered TA in the sphere of fiscal reform with the intent to create a Russian tax system that is more appropriate to a modern, market-based economy. For example, USAID/Russia contractor Georgia State University began its two-year Fiscal Reform Project in December 1997. Its workplan included deliverables in the areas of tax administration, tax policy, economic analysis, intergovernmental fiscal relations, and property tax. IMF-funded TA on aspects of tax policy and tax administration has continued in parallel and in close coordination with the USAID program. The IMF has dealt with a variety of policy areas, such as VAT, energy taxation, export and excess wage taxes, and, intensive analysis of monthly variations in tax collection. Since 1993, the Fund has had a resident advisor at the Ministry of Taxation, (formerly the State Tax Service), whose responsibilities have included assistance in the operation of the VAT administration, the development of a program for reorganization of functions, and the improvement of information systems. Another complementary initiative is the World Bank's Tax Administration Modernization project, approved in 1995, with an emphasis on computerization. The US Treasury is currently working closely with the Ministry of Taxation and the World Bank to continue and expand this project.

### **III. INFORMATION SOURCES**

This is not an exhaustive list of available information sources, but the items below provide the Team with most of the available and relevant documents housed at USAID/Russia.

Request For Proposal #118-97-001 for Tax Reform.

Georgia State University Contract proposal dated November 7, 1997.

Contract with Georgia State University for the period of December 17, 1997 to December 16, 1999 for \$10,599,535.28.

GSU biweekly and quarterly reports submitted to USAID/Russia.

All GSU project files and reports are available at USAID/Russia.

Various fiscal reform studies, articles, and reports.

Donor organization project officers and contractors engaged in Russia.

Project Officers in USAID/Russia, GSU advisors and staff, subcontractors, counterparts, local authorities, and organizations implementing affiliated programs will serve as important sources of information for the purposes of this evaluation.

#### **IV. PURPOSE OF EVALUATION**

The purpose of the evaluation is to assess the impact of technical assistance on Russia's fiscal reform from 1997 to present. The work will investigate both the impact of USAID/Russia TA on Russia's fiscal reform and TA delivered by other donor organizations active in Russia's fiscal reform process. The final aim of this study is to identify the value and direction of future work in this area.

More specifically, donor organizations such as OECD, TACIS, IMF, World Bank, US Treasury and USAID/Russia have been active participants in the provision of TA in Russia's fiscal reform process for many years. Donors often coordinate their programs and at times share funding responsibility for projects in fiscal reform. Areas under the heading of fiscal reform include tax administration, fiscal federalism (also referred to as intergovernmental fiscal relations), revenue forecasting, tax policy, economic analysis and property tax. One main goal of this evaluation is to highlight specific areas where positive results can be clearly seen and to cite specific causes and effects of these successes. Such analysis can be utilized by replication of lessons learned in future fiscal reform work.

#### **V. EVALUATION QUESTIONS**

The evaluation questions can be separated into two areas. The first and most important line of questioning concerns the impact of TA on Russia's fiscal reform. The second area investigates the underlying aspects of TA impact on fiscal reform in Russia.

The following list of questions is not meant to be exhaustive, but illustrative of the issues that should drive this evaluation.

##### **I. Impact of TA on Russia's fiscal reform**

1. What effect has TA had on Russia's path toward fiscal reform to date? (the five main areas of fiscal reform can be investigated in this question)
2. Which component of Russia's fiscal reform has witnessed the most positive results from donor assisted TA?
3. Which donor projects have been most successful? Why?
4. Has USAID sponsored Georgia State University's Fiscal Reform Project had a positive impact of Russia's fiscal reform? If so, in which specific areas?

5. Has GSU's TA addressed the Mission's strategic objective and indicators?
  6. What are the areas of most fruitful future TA? Why?
  7. What is the value of future TA for Russia's fiscal reform in particular and its economic development in general?
- II. Underlying indicators of TA effectiveness
1. What role does culture play in the effectiveness of TA? Do foreign advisors make cultural mistakes that damage counterpart relationships?
  2. Which counterparts are the most receptive to TA?
  3. What role do Russian experts, advisors and assistants play in delivering TA to counterparts at all levels in Russia's fiscal reform?
  4. Are the requests received from project counterparts of high quality?
  5. Which requests for future work should be followed through? Why? What results can be achieved?
  6. What do the counterparts in fiscal reform require that they are not finding in donor assisted TA?
  7. Given the upcoming Duma and Presidential elections, will future TA be effective?

## **VI. EVALUATION METHODS**

The overall evaluation methodology will be left to the discretion of the evaluators and can be finalized by the evaluators in collaboration with the USAID/Russia Evaluation Team and Activity Managers. However, USAID expects that at a minimum the evaluators will:

1. Review and analyze the existing performance and background information;
2. Interview field staff of USAID, the implementing organizations, other donor organizations implementing associated programs, including private sector organizations, Russian Federal, regional and local government counterparts;
3. Conduct site visits to a representative number of cities and regions in the Russian Federation, including Moscow, Novgorod and Vladimir.

## **VII. SCHEDULE**

Approximately six weeks are estimated to complete this evaluation with an assumption of a five-day work week. A representative work schedule is indicated below, but it may be modified on mutual agreement between the outside team and the Evaluation Coordinator.

Activity	Description	Location	Approximate Dates
Background	<p>Finalize schedule, review background documents and performance information, design a list of interviews, develop survey instrument(s) and report outline.</p> <p>Finalize and discuss the methodology and the scope of work with Evaluation Coordinator.</p> <p>Select sites to visit and draft the schedule. Start logistical arrangements.</p>	Moscow	September 6 – 10
Interviews and site visits	<p>Interviews with Mission and Provider's staff, subcontractors, counterparts, and other donor funded organizations and contractors implementing fiscal reform programs.</p> <p>Finalize travel schedule with USAID/Russia. The team may wish to split into two sub-teams and visit different regions where the project has been implemented.</p> <p>Conduct site visits.</p> <p>Begin drafting reports. Report structure discussion with the USAID/Russia.</p> <p>First draft of the report prepared. Briefing to USAID/Russia.</p>	Moscow and Russian regions	<p>September 13 – October 1</p> <p>October 4</p>
Analysis, Report	<p>Draft final report design, additional interviews, if necessary.</p> <p>Final report draft submitted to USAID/Russia for comments.</p> <p>USAID/Russia reviews and comments final draft.</p> <p>Incorporate the comments into the report, finalize and submit to USAID/Russia.</p>	Moscow	<p>October 4 – 11</p> <p>October 11 (due date, 10AM, Moscow time) October 11-13</p> <p>October 15</p>

The final report is expected to be submitted to USAID no later than October 18, 1999.

## VIII. REPORTING AND DISSEMINATION REQUIREMENTS

The final report will include an overall assessment of the issues listed in the section "IV. Purpose of Evaluation" and will address the questions listed in the section "V. Evaluation Questions".

Other information to be included in the report will be determined in consultation with USAID staff over the course of the evaluation.

The electronic version of the final report in MS Word on a diskette and 5 hard copies will be submitted to USAID/Russia. The structure and format of the report will be proposed by the evaluators and approved by the Evaluation Coordinator at the beginning of the evaluation. The evaluation report will primarily be for internal use by USAID project management. It may, at USAID's determination, be disseminated to outsiders.

## **IX. TEAM COMPOSITION AND PARTICIPATION**

The evaluation will be carried out by a two-person team of experts and one support staff person who will serve as an interpreter and logistics coordinator. Experts in the team will be outside hired consultants, preferably with fiscal experience, one of whom will serve as team leader. The fieldwork might be supplemented by USAID Mission staff, as available/appropriate. The members of the team are as follows:

- Team Leader: Responsible for coordinating and directing the reporting effort, including preparation and submission of the draft and final report. The incumbent should have extensive overseas program evaluation experience, including USAID experience, preferably in the ENI region. S/he must be thoroughly familiar with techniques of program appraisal. As team leader, the incumbent should possess knowledge of the fiscal reform process in economies in transition, excellent organizational, team-building, and writing skills.
- Fiscal Reform Specialist: Must possess both overseas and evaluation experience and be preferably familiar with USAID development programs. Ideally, this consultant should have a combination of consulting experience that includes fiscal reform work and exposure to public finance issues in the ENI region.
- Interpreter and Logistic Coordinator: S/he should have knowledge of terminology and specifics related to public finance. S/he will interpret conversations between the evaluation team and Russian-speaking project participants, as well as translate any Russian language documents provided to the evaluation team. Experience in simultaneous translation is desired. This person will also be responsible for all necessary actions as a Logistic Coordinator (i.e. scheduling, arranging meeting, purchasing tickets, etc.).

## **X. BUDGET**

The current Grant does not budget funds for an evaluation. PD&S funds will be used to fund this evaluation. Team members from USAID if necessary will be funded from their contracts.

An estimated budget for this evaluation is attached.